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NOMINATION

HEARINGS

BEFORE THE

COMMITTEE ON
LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON

FRANCIS XAVIER LILLY, OF MARYLAND, TO BE SOLICITOR, U.S. DEPARTMENT OF LABOR

FEBRUARY 8 AND MARCH 14, 1984

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NOMINATION

WEDNESDAY, FEBRUARY 8, 1984

U.S. SENATE,
COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, DC.

The committee met, pursuant to notice, at 8:33 a.m., in room SD-430, Dirksen Senate Office Building, Senator Orrin Hatch (chairman of the committee) presiding.

Present: Senators Hatch and Metzenbaum.

Also present: Senator Mathias

OPENING STATEMENT OF SENATOR HATCH

The CHAIRMAN. The purpose of today's hearing is to consider the nomination of Francis Xavier Lilly to be Solicitor of Labor, a position he has held on an acting basis for the past 9 months.

I certainly appreciate the willingness you have demonstrated, Mr. Lilly, in making yourself available to meet with interested Senators and staff. It is my hope that we can act upon your nomination expeditiously, if we can.

When I became chairman of the committee in 1981, one of my top priorities was to try to work with the Labor Department to reverse the deplorable employment record established under prior administrations. Hearings were held on the Department's handling of the *Teamsters Central States Pension Fund* case, which it had been investigating, to use the term loosely, for almost 20 years. Similar hearings were held on the Department's investigation of Morris Shenker of the southern Nevada culinary and bartenders pension trust, and on the developing backlog in the Solicitor's office of investigations conducted by the Office of Pension and Welfare Benefits Program.

In addition, I held hearings on the Department's Office of Organized Crime and Racketeering to ascertain whether the agents in that Office should be granted traditional police powers.

Over the past 3 years, your predecessor, Tim Ryan, has taken several commendable steps to reverse the Department's record. He has established a respected enforcement team that would be the envy of many private law firms. I am sure you will agree, however, that what Mr. Ryan has begun must be completed before any of these initial efforts can be classified as successes.

Having reviewed your record and watched you in action over the past 9 months, Mr. Lilly, I am convinced that the Department will be well served during your tenure as Solicitor of Labor, and I am confident that under your direction the Department's enforcement effort will continue to improve.

I sincerely hope, in fairness to you and on behalf of the Department, we can move quickly on your nomination.

Senator Metzenbaum, do you have any opening remarks?

OPENING STATEMENT OF SENATOR METZENBAUM

Senator **Metzenbaum**. Yes. I think that Mr. Lilly's appearance before us today and the fact that he has been the Acting Solicitor for 9 months gives us a chance to raise some questions as to the policies of the Department of Labor because there is a general consensus out there that the Department of Labor's policies have actually been a disaster for labor, for workers, and the unemployed. The Department seems to have become less active—not seems to, it has become less active—in the implementation of the Job Training Partnership Act than I think Congress expected it to be.

It has administered labor standards inequitably. It has failed to take an active interest in protecting the retirement security of the Nation's workers. I particularly want to address that issue with Mr. Lilly this morning. It may be necessary that we have Mr. Lilly back with some of the records pertaining to some of the cases that have made it possible for corporations to dissolve their pension plans, take into their own treasury literally hundreds of millions of dollars, fail to provide adequately for the workers; and the Department of Labor has acquiesced under your direction in connection with some of them. I particularly want to address the issue of the *Harper and Row* case.

I think that it very much goes to the qualifications of the Acting Solicitor to be named Solicitor General. As you may or may not know, prior to the end of the last session I was prepared to offer an amendment to freeze the processing of terminations of overfunded pension plans in which there is a potential reversion to the employer of more than $1 million. These terminations have been occurring at a hectic pace, and the windfalls to employers are astounding. We have not heard a peep out of the Department of Labor. Some of this activity falls directly under you and has fallen within your orbit of responsibility. As best as I can find out, you have failed to take any action to protect the workers.

In the past 3 years employers have received $1,200,000,000 by terminating pension plans. Occidental Petroleum recently received $367 million. As we sit here, companies are waiting approval from Government agencies in order to get their hands on at least a half billion dollars more from these plans. The Department of Labor has remained silent.

In the majority of cases these recaptured assets are used to retire long-term debt, fund new acquisitions, fight off takeovers, and for other corporate purposes, but the funds were there for one purpose, and that is to provide retirement security for the workers. Typically, employees have not been consulted prior to plan terminations. Their security upon retirement has oftentimes been jeopardized. Lump-sum payments made to workers after a plan is terminated are often insufficient for the purchase of an annuity contract. The termination will probably eliminate any early retirement options the employee might have chosen to exercise, and older workers are not being protected by their Department of Labor and they are unable to find jobs which will provide them with the pension coverage that the money was there to provide them with.

To the best of my knowledge, the Department of Labor has failed to take any enforcement or other administrative action that would discourage the continued termination of viable, healthy plans. The Department's position is that a plan sponsor is free to terminate a pension plan at any time for any reason. This Senator believes that that is failing to meet your responsibility.

Now as the administration's nominee to be the Solicitor of Labor, you are going to be responsible for the enforcement of the Employee Retirement Income Security Act [ERISA], and the protection of the retirement security of workers throughout the country.

However, your past performance, I must say, raises grave concerns as to your desire and willingness to be aggressive in protecting workers' needs. I hope that you can explain that to us.

I might say to you that I think you have some obligation to explain what in your background or what there is about you that would warrant and cause us to feel that we can count upon you for some protection for working people.

You have been with the biggest law firms. You have been with the National Association of Security Dealers. You have been with Wilmer, Cutler & Pickering. You have been with Arent, Fox, Kintner, Plotkin & Kahn. You have been with the White House. That's nothing, of course—I mean from the standpoint of corporate representation. You have been with Bryan, Cave, McPheeters & McRoberts, and you have been Executive Assistant to the Chairman of the U.S. Synthetic Fuels Corporation.

Senator MATHIAS. You're stealing my speech, Senator.

Senator METZENBAUM. Well, it is the first time I have ever been able to get away with anything stolen from you, so I feel proud of myself this morning. [Laughter.]

All of those background positions give you good legal background, and maybe we ought to have you up here to be confirmed as Attorney General of the United States instead of the President's contemplated nominee, but that is not what you are up here for. You are up here to be confirmed as Solicitor of the Department of Labor.

I would like to know why the working people of this country or the unemployed of this country, for that matter, or those who are hoping to go on pension can have any reason to believe that they can look to you with some comfort and security.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Metzenbaum.

Senator METZENBAUM. I yield to the very distinguished Senator from Maryland.

The CHAIRMAN. Thank you. We are delighted to have the distinguished Senator from Maryland here.

Senator Mathias, we appreciate your coming this early in the morning. We will turn the time over to you.

STATEMENT OF HON. CHARLES McC. MATHIAS, JR., A U.S. SENATOR FROM THE STATE OF MARYLAND

Senator MATHIAS. Thank you, Mr. Chairman.

I have a great pleasure and a great privilege in introducing an able citizen of Maryland who has been nominated by the President of the United States to be Solicitor of the Department of Labor.

With the help of the distinguished Senator from Ohio, you already know about his legal connections. They have been distinguished law firms with which he has been associated. Therefore, I will not repeat that as a part of my introductory remarks, but I was going to do that, Senator. It is nothing to be ashamed of.

Senator METZENBAUM. Oh, no, I agree with that. He should not be ashamed of it. They are good firms.

Senator MATHIAS. I think it should be well advertised.

However, there is a rare facet to Mr. Lilly that I should point out. He is one of those unusual people who was actually born in the District of Columbia. There are not very many of them, but he is one.

However, he has transcended even that distinction by showing the good judgment to move to the State of Maryland, where he resides in Bethesda. He is my neighbor. We are very proud that he chose to come to Maryland. Having done that as a matter of choice rather than the accident of birth, why, it is a more significant decision. So we hold him in great esteem.

He went to Duke University. He went to Catholic University. As Senator Metzenbaum has said, he has an unusual opportunity to gain experience in the private practice of law, but he also comes to this position with 2 years' experience in the Department of Labor itself: first, as Deputy Solicitor and, since April of last year, with full responsibility for directing the Office of the Solicitor. He comes with on-the-job training.

I am sure that he will be able to answer the questions that the Senator from Ohio has posed. I hope to give the Senator from Ohio full assurance on all of those questions. They are serious questions and ones that I would concur deserve serious attention.

I commend him to the committee. I hope that his nomination can be favorably reported in the very near future and that he will be confirmed by the Senate by an overwhelming, unanimous vote.

The CHAIRMAN. Thank you so much, Senator. We appreciate your being here. We know how busy your schedule is.

Mr. Lilly, it is a great compliment to you that he has taken the time to be here with you this morning. We certainly observe that.

Thank you for being with us.

Mr. Lilly, I have read your excellent statement. I would suggest that you just summarize in a short statement for the record, so that we can ask questions because we have a limited period of time here this morning. I will only ask one question, and then turn it over to Senator Metzenbaum.

STATEMENT OF FRANCIS X. LILLY, NOMINATED TO BE SOLICITOR OF LABOR

Mr. LILLY. Thank you, Mr. Chairman.

I would first like to thank Senator Mathias for introducing me today and for his very kind remarks. I know he has a very busy schedule, and I appreciate his taking the time to appear with me today.

I also want to thank you, Mr. Chairman, and all the members of this committee for scheduling the hearing on my nomination so quickly after the beginning of this session.

Mr. Chairman, I am deeply honored by the confidence that President Reagan and Secretary Donovan have shown in me through their action in nominating me for the very difficult and challenging position of Solicitor of Labor.

I would also like to take this opportunity to thank my wife, Kitty, and our four wonderful children, three of whom are sitting back here behind me, even though they had to get up at the crack of dawn this morning to be here. They have provided not only their total and my greatest support, but, perhaps even more importantly, their understanding during my past 3 years of Government service and the 14-hour days and the 6-to-7-day weeks that have attended those 3 years.

Senator Metzenbaum. Where is Christopher?

Mr. Lilly. Christopher Edward could not make it this morning, Senator, because, being of the tender age of 1½ years old, we decided he had to sleep in and he might cause a ruckus if he came down here.

Senator Metzenbaum. Would you tell Christopher Edward that we were looking for him? If we have another hearing, we want you to be sure to bring him. However, we are pleased to have your other three children and your lovely wife with us this morning.

Mr. Lilly. Thank you, Senator.

Senator Metzenbaum. Do they have the day off from school for doing this?

Mr. Lilly. We had to get permission to take them out a half a day, Senator, but I don't think they will get the whole day off—hopefully not, anyhow. We'll be back by lunch. [Laughter.]

The Chairman. It all depends on Senator Metzenbaum. [Laughter.]

Senator Metzenbaum. Do you want to stay off a whole day? [Laughter.]

Mr. Lilly. Mr. Chairman, that may divide my family up inequitably.

I believe that I can comment fairly on both aspects of the Solicitor's job that I mentioned earlier, the difficulties and the challenges.

I served as Deputy Solicitor, as Senator Metzenbaum has pointed out, from January 1982 through April 1983 under Tim Ryan and worked very closely with him during that period. After he resigned as Solicitor in April 1983, Secretary Donovan delegated all of the Solicitor's duties to me. Thus, for the past 9 months I have carried out the responsibilities of that position. Last November President Reagan nominated me for the Solicitor's position and renominated me this January during the new session of Congress.

My experience at the Department of Labor over the past 2 years has been demanding, challenging, and exciting. Under the leadership of Secretary Donovan, the Department of Labor has taken significant strides toward the realization of the President's goals of getting America back on its feet and proud again.

In the interest of time, Mr. Chairman, I had intended to review what I believe to be some of the highlights of the Department's accomplishments in the past few years, but, rather than do that, in light of the Senator's questions and the important subjects which he has raised——

The **Chairman**. I have read it, and I think your review is good.

Senator **Metzenbaum**. Would you tell us, before you skip over the whole Central States matter, since that does get rather close to home for me coming from the community from which the president of that overall union comes, are there any continuing activities going on in connection with that or the Teamsters Union generally?

Mr. **Lilly**. Yes, Senator. In terms of the Central States matter, there is quite a bit of continuing activity, both with regard to the pension fund and the health and welfare fund. With regard to the health and welfare fund case—really two cases, Donovan versus Dorfman and Donovan versus Robins in the Northern District of Illinois and Chicago—as a matter of fact, as we sit here today, very shortly, at 9 o'clock this morning in Chicago, a trial will continue on what we refer to as Count 7 of the Donovan versus Robins-Donovan versus Dorfman trial, in which the question of the valuation of the assets of the Amalgamated Insurance Companies, Mr. Dorfman's operations, are being challenged by the Department of Labor as being excessive.

As you are probably aware, the Central States Health and Welfare Fund paid approximately $10.7 million into the registry of the court last year, in return for which essentially the assets of Amalgamated that the fund thought were necessary to do in-house claims processing were transferred to the fund. That was done pursuant to an agreement that required the valuation to be tested in the courts as to whether or not it should be left where it was or reduced or increased. That particular count, Count 7, on the valuation question is before Judge Will as we speak. The trial started on Monday and it will continue, we think, through the balance of this week. The Department of Labor has challenged that valuation and said that the value should be far below the $10.75 million and the rest of the money should be returned to the fund and not paid to the Dorfman——

Senator **Metzenbaum**. What is that $10.75 million?

Mr. **Lilly**. That $10.75 million figure came from a valuation of the assets of Amalgamated Insurance Agencies and some related companies.

Senator **Metzenbaum**. Those are the Dorfman companies?

Mr. **Lilly**. Those are the Dorfman companies, correct, Senator.

That was the value that the independent investment banker placed on those assets that the health and welfare fund would need in order to do their own in-house claims processing. As you are well aware, under the health and welfare plans of the Central States Conference, an enormous number of claims are processed every year. That plan, that conference, has an excess of 500,000 participants and beneficiaries. As a result, they process hundreds of thousands of claims every year. I think it is actually in the millions. In order to do that in the past, they had contracted with Amalgamated, with Dorfman's entities, to do that, and were being paid an enormous sum of money.

The Department has challenged, among other things, the use of that type of a service on a contract basis as opposed to doing it in-house. As a result of the discussions and the litigation that have gone on for years, as the chairman has pointed out, what has resulted is that the fund has decided to do its own in-house claims processing. In order to accomplish that, however, they had to have the facilities necessary to take care of that in-house claims processing and they figured the best way to do that and the most expeditious way to do that, so that there would not be an interruption in the claims process, was to acquire the assets of the Amalgamated Insurance operations.

In order to do that, however, they had to engage in a number of steps, one of which was to retain an outside entity of one sort, somebody who had the ability to evaluate the value of those assets. They did that, and that evaluation, which the Department of Labor is now challenging before Judge Will in this trial that is ongoing right now—that evaluation came up with a figure of $10.75 million. The Department has stated that that figure is far too high, and that is what we are arguing in front of Judge Will right now.

To the extent that we are successful in lowering the $10.75 million figure, that money will not go to Mr. Dorfman's estate or to his companies, but rather will go back to the Central States Health and Welfare Fund. That is the basis on which we are challenging—that that was too much money to be paid for those assets; the valuation was wrong, incorrect; and that is ongoing right now.

In addition, there are six other counts in that particular complaint that say that the Dorfman companies overcharged the health and welfare fund substantially and that we have asked that any amount that is determined by the court to be the fair value of the assets of the Amalgamated companies that have been transferred to the plan, that any claims of the Department of Labor which are sustained as being overcharges by the Amalgamated and Dorfman-related companies be offset against the amount that would otherwise go to the Dorfman's, and that that amount be returned to the fund as well. Those proceedings are ongoing. We expect them to take a substantial portion of time to be fully tried and resolved.

In addition, on the pension fund side, we have reached settlement agreements which are subject to court approval with the current trustees on the pension fund in the pension fund case. As my statement, which I will submit for the record, goes into more detail in explaining, we are at the present time continuing our discussion with the former trustees, although in that case the court in related civil action, private action, has sent out a notice to class members, or is about to send out a notice to class members, in a case with which our case, the Secretary's case, was consolidated, saying that a settlement may be proper. We have objected to that settlement on the basis that we think we can prove that the former trustees engaged in actions which cost the plan, its beneficiaries, participants in excess of $37 million in losses. This settlement would let all of the former trustees out of the case with less than $2 million of contribution by them. We think that is insufficient.

Senator METZENBAUM. What is the $6.5 million figure that you mentioned in your statement?

Mr. LILLY. The $6.5 million figure is the figure that was arrived at in terms of the settlement of a number of cases involved in the pension side of the Central States matter that would take care of a number of claims the Department has and return that $6.5 million to the fund. That would take care of what we refer to as the *airplane* case, the *McDougal* case; the case in Florida, the *Nulles* case.

It would settle prior to litigation, with the savings of the expenditures for litigation, the attorneys' fees matters that we have with regard to the current trustees. We think it would go a long way toward accomplishing for the fund and its current trustees the new day which all of the people at the fund are seeking to arrive at now.

Senator METZENBAUM. How does that relate to the $2 million figure? Does that have some relationship? You mentioned a $2 million settlement that you are opposing and the $6.5 million you have agreed to. I am not quite clear as to what the distinction is.

Mr. LILLY. The $2 million proposal that is being put forward by the plaintiffs in the private action is the amount, the entire amount, that the former trustees would contribute to the settlement of the private action in the Donovan and the *Donovan* v. *Fitzsimmons* case that have been consolidated. We have opposed the consolidation. We have gone to the seventh circuit court of appeals and said that consolidation should not take place; the settlement notice should not go out. The court said we can come back later, essentially; we are not going to be irreparably damaged by the settlement notice going out at this time.

That settlement would provide for the contribution by the former trustees of only $2 million. We think that is grossly inadequate. That is only a proposal at this point.

The $6.5 million which I mentioned in the statement is the amount that the current trustees and the insurance companies have agreed to come up with to settle a number of other cases, not the *Donovan* v. *Fitzsimmons* case.

The CHAIRMAN. Mr. Lilly, let me interrupt here at this point. We are running out of time.

I want to thank you for your statement. It is a good statement.

I think that there are other members of this committee who have questions that they will submit to you in writing, and I will submit my questions in writing, too. I would like to ask those two this morning, and then we will recess this until 10 o'clock on Friday, and we will just go all day if we have to do so.

Senator METZENBAUM. Mr. Lilly——

The CHAIRMAN. Excuse me, Howard. Let me ask my questions.

Senator METZENBAUM. I am sorry. I did not mean to interrupt you.

The CHAIRMAN. The one question I have is, I notice in your statement with regard to the *Culinary Workers* case, we had a lot of criticism for bringing some of those investigations, criticism all over Washington and some other places, although I think most of the commentary was pretty favorable.

As I notice in your statement, you say that there was a $3.7 million restoration, monetary settlement, that was restored to the pension trust, and then there was $35 million, a jury verdict of $35 million against Mr. Shenker and two of the corporations he controlled. Is that verdict against him individually?

Mr. LILLY. Yes, Mr. Chairman.

The CHAIRMAN. And jointly and severally with the corporations he controlled?

Mr. LILLY. I believe so.

The CHAIRMAN. Does that include The Dunes?

Mr. LILLY. No, I think it includes the corporations that are stockholders in The Dunes Hotel as opposed to The Dunes itself.

The CHAIRMAN. As I understand it, the ERISA claims still are to be decided by the judge.

Mr. LILLY. That is correct.

The CHAIRMAN. You have already had settlements and judgments of almost $39 million against Mr. Shenker and those who were involved in this matter for and on behalf of the culinary workers?

Mr. LILLY. That is correct, Mr. Chairman.

The CHAIRMAN. That is pretty successful.

Mr. LILLY. We think that it is a major step toward making sure that the trustees, the fiduciaries, of pension plans around the United States recognize that Secretary Donovan and his Department of Labor are going to enforce this law vigorously in all respects. We were very, very pleased with the jury verdict that came in on behalf of the Carson Management Group in the case. We, of course, would not want to comment on what the court is going to do with regard to our claims.

The CHAIRMAN. Has that verdict been appealed?

Mr. LILLY. I think, Mr. Chairman, it has not yet been appealed, but I believe that the——

The CHAIRMAN. Time has not yet expired?

Mr. LILLY. Time has not yet started to run on that because of the judge's——

The CHAIRMAN. So you anticipate an appeal?

Mr. LILLY. Mr. Shenker, as you may well be aware, Mr. Chairman, has filed, I believe, a chapter 11 petition in bankruptcy. The result of that is that I think we are going to have another bonanza for the lawyers in terms of an awful lot of legal activity. Whether or not that will complicate his determination on whether or not to file an appeal in this particular case, I am not sure. If it does not complicate or even preclude it, I would be very surprised if Mr. Shenker and his corporations, based on the prior activity, would not file——

The CHAIRMAN. Therefore, in addition to the almost $39 million that your Department really has won in settlement or in court, you are still pursuing the ERISA claims as well?

Mr. LILLY. Absolutely.

The CHAIRMAN. These claims will be decided by the judge?

Mr. LILLY. Correct.

The CHAIRMAN. I want to compliment you and those down at the Labor Department for the work that you have done in this area. I think that is a prime case of workers who work for the minimum wage who have been absolutely ripped off by these people whom I consider to be elements of organized crime. You have not allowed them to get away with it. I think this committee has played a little role in that, too.

We get a lot of criticism for some of these investigations we have conducted, but we have had a lot of good results as a result of those investigations in protecting workers' rights.

I want to commend you for that. I personally want to commend you and Mr. Ryan and tell you I appreciate it.

Mr. **Lilly**. I think a large portion of the success we had in that case was resulting from the fact that after we came up here and talked with you about that earlier, that type of airing of the problems in a case gives great impetus to everybody involved in it, in addition to which the Department, after that type of discussion with you, gets additional resolve to carry something like that all the way through. We have been very, very successful due to the efforts of an awful lot of very dedicated attorneys and other professionals at the Department.

If I could just tie that in for a moment to a question that Senator Metzenbaum asked a moment ago, the Secretary has committed whatever resources are necessary and available to us at the Department to pursue, as vigorously as possible, any violations of the ERISA statute, because I think he recognizes, as Senator Metzenbaum has pointed out, that these are some of the most precious rights that the American working people do have.

We have taken strong and vigorous action in the area of takeovers, the use of pension plan funds in takeovers and takeover attempts. The Senator may be aware of our action in the *Grumman* case in New York and the *Simmons* case in Illinois. We are currently engaged in a very significant effort at the Department to examine very, very carefully the whole question of pension plan terminations, and we will continue to do that.

Senator **Metzenbaum**. Would you support a congressional 9-month moratorium in order that a policy may be established, since we know that $1,200,000,000 has now slipped out the door, and employees will never see that money?

Now I am not prepared to say what the ultimate answer is, because there are some equities on the employers' side as well as on the workers' side, but there are some tax aspects as well.

I would like to see a 9-month period so that the proper committees of this Congress, probably the Finance Committee as well as this committee, the overall committee, would have a chance to explore the entire issue with your Department as well as the PGBC, and the IRS.

The **Chairman**. Let me add to that. I think the Senator from Ohio has raised a very important set of issues here. I would suggest that the Department of Labor really consider having a task force to help us know up here what we can do. We will be happy to hold hearings and get into this in more detail on where Senator Metzenbaum and I both have a tremendous interest.

Senator **Metzenbaum**. If you supported a 9-month moratorium, we could whip it through here. If you don't, then Senator Nickles has agreed that he will conduct hearings on the subject, but it is understandable that he cannot do it until March. I am concerned that while this happens, literally hundreds of millions of dollars are going out the door.

There are pending cases at your Department now. While you do have the authority to hold them up, you didn't hold up Harper and Row.

Incidentally, would you make available to my staff the entire file on the *Harper and Row* case, please?

Mr. LILLY. Senator, we received your letter, I believe yesterday, asking for that. We have all of that material assembled. I believe that we have already made most of that material available to some other folks up here, so I do not think there will be any problem.

The CHAIRMAN. Why don't you get as much as you can?

[The material referred to follows:]

MEMORANDUM FOR: ROBERT N. ECCLES
Acting Associate Solicitor, PBSD

FROM: CHARLES M. WILLIAMSON
Acting Assistant Administrator
for Enforcement, PWBP

SUBJECT: Harper and Row Publishers, Inc.,
Retirement and Profit Sharing
Plans (the Plans)
New York, New York
Case No. 30-10159(48)

Attached is a Report of Investigation with exhibits, supplemental evidence, a PBGC file and Area and Regional Office memoranda involving an investigation of the above subject plans. Also, attached are 5500 filings that we have been able to locate for the Harper and Row Publishers, Inc., Retirement Plan (the Retirement Plan) and the Harper and Row Publishers, Inc., Profit Sharing Plan (the Profit Sharing Plan).

At this time, it is requested that you supply this office with an analysis and opinion with respect to the best legal argument for a Departmental finding that the fiduciaries of the Retirement Plan and Profit Sharing Plan violated the fiduciary standards of ERISA. As elaborated upon below, we are particularly interested in your views as they relate to violations of ERISA sections 404(a)(1)(A), 404(a)(1)(B), 406(b)(1) and 406(b)(2).

SUMMARY OF SIGNIFICANT FACTS

Potential fiduciary violations in this case revolve around the determination of the Harper and Row Board of Directors to terminate the Retirement Plan, amend the Profit Sharing Plan and establish a Harper and Row, Publishers, Inc., Employee Stock Plan (the ESOP). The investigation provides evidence to indicate that the aforementioned actions of the Board of Directors served to facilitate the plan sponsor's purchase of over 1 million shares of Harper and Row Common Stock from the Minneapolis Star and Tribune Company (MST). The investigation also supplies evidence to indicate that the decision of the Board of Directors to purchase common stock from the MST was motivated by a desire to prevent the stock from being sold on the open market.

As can be seen in exhibit 4 of the Report of Investigation, on September 15, 1982, the plan sponsor entered into a Stock Purchase Agreement with the MST to purchase Harper and Row Common Stock at $20 per share. In order to finance part of the purchase, the Board of Directors with stockholder approval decided to "restructure" its employee benefit plans. In brief, this "restructuring" of the Harper and Row employee benefit plans provided more than half of the $21.4 million the plan sponsor needed to purchase the common stock from the MST. 1/

Evidence uncovered by the investigation indicates that the purchase of common stock by the Profit Sharing Plan and establishment of the ESOP (with corresponding plan sponsor common stock contributions) was, at least in part, designed to "... discourage any attempt by one or more persons to acquire control of the Corporation" (see page 12 of exhibit 4). The investigation reveals that after the plan sponsor contributed to the ESOP the stock which was purchased from the MST and after the Profit Sharing Plan purchased plan sponsor stock, 2/ the ESOP and the Profit Sharing Plan became the two largest shareholders of Harper and Row Common Stock.

Another factor which may have a bearing on whether violations occurred involves the manner in which benefits will be paid to participants after the plan sponsor terminated the Retirement Plan. The investigation and a private civil suit 3/ indicate that the amount of Retirement Plan assets (approximately $9.8 million) which reverted back to the

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1/ Approximately $9.8 million was obtained after the termination of Retirement Plan and about $1.5 million was obtained after the Profit Sharing Plan was amended to permit the purchase of employer qualifying securities (i.e. Harper and Row Common Stock).

2/ The Profit Sharing Plan purchased the stock on December 9, 1981 for $11.34 per share which was the mid-point between the bid and asked price as of December 8, 1981, on the over the counter market. The stock contributed to the ESOP was valued at $13 per share. Currently (Aug. 1982), the common stock of Harper and Row sells in the range of between $8 and $9 per share.

3/ The suit was filed in June 1982 by District 65, UAW and Renee Casiero (an employee) against, among others, the plan sponsor, the MST, Prudential Insurance Company and PBGC. A copy of the complaint is attached for your information.

plan sponsor for the purchase of stock from the MST was dependent upon the type of arrangements which were made to pay benefits to participants. In this regard there is evidence to question a 15% interest rate assumption which was used in an annuity contract purchased from the Prudential Insurance Company of America. By using what may be a high interest rate assumption to calculate the present value of accrued benefits and requiring all participants with benefits valued at less than $1,000 to take a cash lump-sum distribution, the plan sponsor was able to obtain the $9.8 million needed to finance the purchase of stock from the MST. [4]/

POTENTIAL VIOLATIONS

Our analysis of the evidence gathered in the investigation leads us to believe that the decisions of the Board of Directors and other fiduciaries in amending the Profit Sharing Plan raise serious questions relating to the sole interest, prudence and self-dealing provisions of ERISA. We also believe that questions are raised with respect to whether the Profit Sharing Plan fiduciaries acted on behalf of a party (e.g., themselves or the plan sponsor) whose interestsare adverse to the Profit Sharing Plan.

In our view and as stated in the Department appellant brief in Donovan v. Bierwirth, et al., ERISA is grounded on the concept that an employee benefit plan must be independent of the employer that sponsors the Plan and that plan assets shall be held (and invested) for the exclusive purpose of providing benefits to participants and beneficiaries. We believe that sections 404(a)(1)(A) and (B) may have been violated because the decisions to amend the Profit Sharing Plan and purchase employer stock were made by fiduciaries whose primary allegiance may have been to the plan sponsor. Particularly troublesome to us with respect to sections 404(a)(1)(A) and (B) is the fact that the Profit Sharing Plan fiduciaries decided to convert a diversified portfolio of high grade debt and equity securities to Harper and Row Common Stock. We believe that there is evidence to indicate that it may have been more in the interest of the plan sponsor than the Profit Sharing Plan to purchase the stock and that the fiduciaries may not have acted at all times solely in the interest of the Profit Sharing Plan participants. In regard to sections 406(b)(1) and (2) of ERISA, we believe the restrictive provisions of the Profit Sharing Plan amendment, the timing of the amendment and the actual plan asset conversion create an impression that the fiduciaries had a conflict of interest. Evidence that there may have been a conflict of interest is especially strong when the actions of the fiduciaries are considered in the context of the plan sponsor attempting to prevent the MST from placing Harper and Row Common Stock on the open market.

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[4]/ Based on correspondence between Prudential and Harper and Row which is identified as attachment 8 of the New York Area Office memorandum dated August 13, 1982, it appears that the original contract with Prudential was changed, after the plan sponsor received complaints, to provide a cash or annuity option to all participants who would be entitled to a lump-sum settlement of at least $250.

With respect to the termination of the Retirement Plan and without questioning the right of a plan sponsor to terminate a plan, we believe there is evidence to indicate that the fiduciary standards established under 404(a)(1)(A), 406(b)(1) and (2) may have been violated. Similar to the Profit Sharing Plan, we believe the decision of the fiduciaries to terminate the Retirement Plan, at the exact time when a large amount of cash was needed to acquire the MST stock, may not have been in sole interest of participants and beneficiaries. When the termination is viewed in the context of the Prudential insurance contract arrangement (e.g., 15% interest rate assumption, etc.) and the benefits participants would have received if the Retirement Plan had not been terminated, a question is raised about whether the fiduciaries were acting solely in the interest of participants and whether the fiduciaries were dealing with plan assets in order to benefit the plan sponsor. The possibility of a self-dealing and conflict of interest violation is also clearly raised by the fact that, after the Retirement Plan terminated and excess assets reverted back to the plan sponsor and the acquisition of MST stock, the Board of Directors decided to establish an ESOP and contribute the stock acquired from the MST to the ESOP.

In transmitting this investigation to you and requesting a legal argument for a finding of fiduciary violations, we recognize that more investigating must be conducted in order to clearly understand the actions of the fiduciaries. Accordingly and in a separate memorandum to the New York Region, a copy of which has been previously sent to you, we are requesting that the additional investigation be conducted as expeditiously as possible. We will transmit the evidence obtained from the additional investigation upon our receipt.

If you have any questions on this matter, please feel free to contact me.

Attachments

cc: Chron Enforcement SOL Referral
Clayton Info New York RO
New York AO

LMSA:PWBP:ENFORCEMENT:DFSI:GAROFOLO.
9/9/82 N4720 Ext. 38834 caw

U.S. Department of Labor

Office of the Solicitor
Washington, D.C. 20210

APR 14 1983

MEMORANDUM FOR: CHARLES M. WILLIAMSON
Assistant Administrator for
Enforcement, PWBP

FROM: ROBERT N. ECCLES
Acting Associate Solicitor, PBS

SUBJECT: Harper & Row Plans

Attached is the official copy of our memorandum recommending against litigation in this matter. From our discussions, I assume that we are all in agreement on this but let me know if you'd like to discuss it further.

Attachment

MAR 04 1983

MEMORANDUM FOR: ROBERT N. ECCLES
Acting Associate Solicitor, PBSD

FROM: LOUIS L. JOSEPH
Counsel for General Litigation, PBSD

SUBJECT: Harper & Row Defined Benefit Plan, Profit Sharing Plan, and Employee Stock Ownership Plan
PWBP #30-10159
PBSD #18-51-721

As explained in more detail below, this case involves the termination by Harper & Row, Inc. of its defined benefit pension plan in order to obtain a reversion to the Corporation of that plan's residual assets. These funds were then used by Harper & Row, together with other corporate assets, to purchase from a third party stock representing a controlling interest in the corporation. A portion of this stock was then contributed to a newly formed ESOP and the balance sold to an existing profit sharing plan. These transactions have given rise to two class action lawsuits by Harper & Row employees alleging violations of ERISA. The Department has conducted an independent investigation and plaintiffs in both lawsuits have requested our assistance.

We have concluded that the Secretary has no claim to assert for which a Court could grant meaningful relief. Accordingly, we recommend that the Department take no further action with respect to this case at the present time, although we may wish to express a view on the appropriate legal standard should the private litigation reach the appellate level. As noted below, after consultation with the other relevant agencies, the Department may also wish to express its views publicly on the general issues presented by these facts, outside of the context of the existing litigation.

FACTS

In February of 1981, the Minneapolis Star & Tribune Company ("MST") informed Harper & Row ("H&R") that it intended to sell its holding in H&R stock, which accounted for 1,017,630 shares, or approximately one-third of the outstanding shares of H&R. Because sale of this block of stock might have led to a loss of control of the Corporation by existing management, the Board of Directors of H&R (henceforth "the Board"), according to the sworn affidavit of H&R's Vice President and General Counsel, considered a) assisting MST in searching for a buyer for the MST holdings, b) attempting to arrange a sale or merger of H&R and c) purchasing the MST-held shares from MST. Allegedly after considering "the financial prospects for Harper & Row, the value of its stock, and the importance that H&R maintain its editorial independence" (defendants' motion for summary judgment in the private suits), the Board decided to purchase the H&R stock, using, in part, what were at the time of the decision, employee benefit plan assets. This decision was made, pursuant to the recommendation of a committee of H&R's outside dirctors, in or about early June of 1981. 1/

In June of 1981, H&R begin negotiations with MST, and on August 4, 1981, an agreement in principle was reached and announced publicly and to H&R's employees. Approval by the Board of H&R occurred on September 15, 1981, after receiving an opinion from Kidder, Peabody that the price contemplated was fair and that financing the purchase would not materially and adversely affect H&R's ability to carry out its business. The Board reviewed and confirmed its decision on October 7, 1981, again after seeking Kidder, Peabody's advice. The plan of purchase, including the restructuring of the employee benefit plans necessary to finance the purchase, was put to the stockholders on December 9, 1981, and approved by them and again by the board. Had the shareholders refused their approval, H&R would have forfeited a one million dollar deposit on the purchase which was then held in escrow.

The plan of purchase which had been negotiated in the summer of 1981 and finally approved in December was essentially as follows. All of the MST shares would be purchased by H&R, that is, 1,018,630 shares, at a price of 20 dollars per share. Thus, the total purchase price was $20.4 million. The purchase price was to be obtained by H&R from a variety of four sources, as follows.

First, H&R's defined benefit pension plan would be terminated, and those assets not used to finance the payment of vested benefits, estimated prior to the sale to be $9.8 million, would be paid to the Corporation.

1/ According to H&R, this decision was reached after receiving financial advice as to the value of H&R stock from Kidder, Peabody, a firm which from time to time had functioned as H&R's investment banker.

Second, the existing profit sharing plan would purchase from H&R $1.5 million worth of the stock to be acquired from MST at the mean between the bid and asked price on the over-the-counter market at closing on the day of sale. To permit this purchase, the profit sharing plan was amended in October of 1981. 2/ Prior to its amendment, the profit sharing plan provided for a) mandatory annual contributions of H&R's profits, and b) a limitation on the amount of employer stock that could be held by the profit sharing plan to less than 10% of its portfolio. The plan was trusteed by an independent bank trustee, Irving Trust. By the terms of the plan, the trustee invested individuals' accounts either in a fixed income fund or an equity fund. Within each fund the trustee had discretion to make investments. After its amendment, the profit sharing plan was permitted by its terms to acquire and hold up to 50% of plan assets in employer stock, and the plan made no provision for mandatory annual contributions. Participants were informed by the Profit Sharing Committee 3/ that no further contributions were contemplated, and the information provided to the shareholders at the time of the vote assumed no contributions for at least five years. The plan amendments provided that the Board of Directors could direct the purchase by the plan of employer stock, and provided that the trustee could sell the employer stock held by the plan only at the direction of the Board, or if necessary to pay benefits provided for in the plan. Upon being informed of these changes in the governing plan document and the intended purchase of shares by the profit sharing plan, the trustee of the plan, Irving Trust, resigned, stating as its reason the fear of litigation alleging breach of fiduciary duty, and citing in particular the Grumman and Marriott litigation.

The remaining funds for the purchase, anticipated to be $9.1 million plus any shortfall on the projected amount to be realized from the employee benefit plans, was to be raised through borrowings by H&R and the sale of certain real estate owned by H&R.

2/ Amendments to the plan, both prospective and retroactive, were specifically permitted under the terms of by the plan document.

3/ Generally, the Profit Sharing Committee had authority for all plan operations other than investments, e.g. the distribution of benefits.

The arrangement approved by the shareholders provided for the contribution of all the stock purchased by H&R and not sold to the profit sharing plan to a newly created ESOP. Like the amended profit sharing plan, the newly created ESOP can only sell employer stock to pay benefits or at the direction of the Board of H&R. It was contemplated that the contributions of this stock to the ESOP would be made in two large and perhaps several small installments, the amount and timing of which appeared to be a function of H&R's tax situation. It was anticipated that the cost of these large contributions would be offset over a five year period by savings to H&R due to the termination of the defined benefit plan and the amendment of the profit sharing plan to eliminate any obligation to make contributions.

H&R's management contemplated that one effect of the stock purchase and restructuring of the plans would be to discourage takeovers. The proxy statement provided to the shareholders prior to the December 9, 1981 vote provided:

> Ownership by the Employee Stock Plan and the Profit Sharing Plan of a substantial block of the Common Stock may discourage any attempt by one or more persons to acquire control of the Corporation. The Corporation has no knowledge of any person expressing a present interest in acquiring control of the Corporation.

The reasons given in the proxy statement for the purchase of the stock make it clear that at least one reason for proposing the purchase was the desire to discourage takeover attempts and to prevent the uncertainty that possible takeover attempts might cause.

To date, the purchase of the MST stock by H&R, the purchase from H&R by the amended profit sharing plan, and the contributions of stock to the newly created ESOP have proceeded largely in accordance with the proposal approved by the shareholders of H&R. Steps to terminate the defined benefit plan were put in motion prior to final approval of the sale. On August 21, 1981, H&R submitted to the PBGC a notice of intent to terminate the plan effective as of August 31, 1981, and requested a letter of sufficiency. About the same time, a request was made to IRS for a determination that the termination would not adversely affect the plan's tax status. Both the PBGC and IRS were advised that as a result of the proposed termination, the excess assets of the defined benefit plan would revert to H&R. The PBGC issued a Notice of Sufficiency on November 6, 1981, authorizing liquidation of the plan on or after December 1, 1981, and the IRS issued a favorable determination letter on November 20, 1981.

Under the terms of the defined benefit plan the plan's Retirement Committee had discretion to make distributions to participants:

> ...in one of the two following ways, the method to be selected in the case of each individual being in the complete discretion of the Committee: (a) in one lump sum, or (b) by the purchase of a non-transferable annuity contract.

The plan document is silent on the subject of how the amount of the lump sum is to be calculated where a lump sum is chosen by the Committee. In fact, the accrued benefits of plan participants were funded through a group annuity contract with the Prudential Insurance Company. 4/ Under the terms of the contract, as it was ultimately modified in or about April of 1982, Prudential provided: (1) an annuity to all participants whose accrued benefit had a present value in excess of $1,000; (2) an option to elect an annuity or lump sum distribution to participants who had an accrued benefit from $250 to $1,000, or who had completed 10 years of service; and (3) a lump sum distribution to participants whose accrued benefits were valued at less than $250.00. In calculating the present value of individual benefits, Prudential applied the 15% rate of interest which it had used as the basis for calculating the group annuity premium charged to the plan. Although the investigation is silent on the cost of individual annuities, it

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4/ The evidence suggests that the Chairman of the Retirement Committee may have entered into the annuity contract with Prudential on behalf of the plan without authorization by the full Committee. Accordingly, it appears that the Committee itself may never have approved the payment of the lump sums (which were provided through the Prudential contract), but that this decision was made by the Chairman of the Committee, an officer of H&R, in violation of the governing plan documents.

is virtually certain that no individual receiving lump sum distributions of under $1,000 or under $250.00 could have purchased individual annuity contracts with such distributions which would have generated monthly benefits equal to their accrued benefits under the Plan. 5/

The actual purchase of stock by the profit sharing plan was accomplished on December 9, 1981. The profit sharing plan purchased 152,588 shares from H&R for approximately 11 5/8 per share, which was based on the average of the bid and asked quotation for H&R shares reported on the over the counter market at the close of business on the day preceding the purchase. The purchase itself was recommended by the Board's audit committee which, on December 8, 1981, consisted of outside directors. This recommendation was adopted by the full board following the shareholder vote on the following day. Testimony and documents reflect that the audit committee and the Board of Directors viewed themselves as plan fiduciaries in making the purchase decision, and concluded that the purchase was prudent after consideration of the Kidder, Peabody study. The audit committee minutes note that

> ...the Profit Sharing Plan fund has the potential for increasing the value of these shares by two or three times if it should decide for some reason in the future to sell the shares as a block and that, the more significant the position taken in the Company stock, the higher the price the Plan might receive for this block.

Private litigation has been brought by two classes of H&R employees, union members and non-union members, alleging that the transactions set out above, taken separately and as a

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5/ The Notice of Intent to Terminate filed with PBGC in August 1981 and the Application for Determination on Termination filed with IRS in September 1981 made no mention of lump sum distributions. PBGC was informed in September of the initial Prudential bid which provided for the lump sum distributions. The IRS became aware of the lump sum distributions and the interest rate used to calculate these distributions by early April of 1982, apparently as the result of participant complaints. Neither agency took any action as the result of this additional information.

whole, violate ERISA's fiduciary responsibility provisions. The lawsuits seek, in essence, to undo these transactions and restore the status quo ante. The defendants are H&R and various members of its board and its officers. Both suits name Prudential as a defendant and one suit names PBGC.

ANALYSIS

1. The termination of the defined benefit plan.

The first issue presented is whether H&R and its Board of Directors were subject to ERISA's fiduciary responsibility provisions in making the decision to terminate the defined benefit plan, a decision which would necessarily lead to the recoupment of millions of dollars in overfunding by H&R. We note at the outset that ERISA specifically contemplates the return of overfunding to an employer upon termination of a defined benefit plan. See, ERISA §403(c) which permits employer recoupment under specified circumstances, and §408(b)(9) which exempts from the prohibited transaction rules of §406 the distribution of assets by defined benefit plans in a manner consistent with §4044; that section, in turn, clearly allows reversions to employers. Courts have repeatedly approved such reversions on the strength of these provisions. 6/

Private plaintiffs argue, however, that ERISA nowhere specifically addresses the issue of whether the decision to terminate itself is subject to the fiduciary responsibility rules. Notwithstanding that fact, the statutory scheme requires us to conclude that a decision to terminate under these circumstances is not subject to the fiduciary responsibility rules. 7/ It would be absurd to conclude that

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6/ See e.g. Pollock v. Castrovinci, 476 F. Supp. 606, 616-17 (S.D.N.Y. 1979), aff'd 622 F.2d 575 (2d Cir. 1980). A separate issue is presented where a plan forbidding a reversion on termination is amended to permit such a reversion. See Audio Fidelity Corp. v. PBGC, 624 F.2d 513, 516-517 (4th Cir. 1980). That issue is not present here.

7/ This view is consistent with testimony given by the Administrator before the House Select Committee on Aging on June 7, 1982 in which he stated that Congress intended a voluntary pension system, and that ordinarily a decision by a

Congress specifically approved of reversions upon termination, but intended that employers who decided to terminate under circumstances which would lead to a reversion had violated the Act and must return the assets received through the reversion to the plan or its participants. Efforts to distinguish "good" terminations from "bad" or illegal terminations based on the use to which the assets reverting to the employer are put cannot be supported by the Act. Once it is accepted that assets reverting to the employer are no longer assets of the plan and thus need not be used to provide benefits or pay for plan administration, it it must also be accepted that the plan's participants and the Secretary have no legally cognizable interest in how these assets are used. 8/

Plaintiffs in the private litigation rely on Eaves v. Penn, 587 F.2d 453 (10th Cir. 1978) and Calhoun v. Flastaff Brewing, 478 F. Supp. 357 (E.D. Mo. 1979) to support their position that the decision to terminate an overfunded defined benefit plan is subject to the fiduciary responsibility provisions of ERISA. Neither case involves the termination of a defined benefit plan, and accordingly, both are distinguishable.

The Eaves case involved the conversion of a profit sharing plan to an ESOP and the subsequent looting of the ESOP by causing it to purchase vastly overpriced stock in the employer, after the employer corporation had gutted itself by contributing all its cash to the ESOP. The scheme benefited, among others, the

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7/ continued:

plan sponsor to terminate a pension plan would not present a violation of ERISA, even though a reversion to the employer resulted. The view that a decision to terminate is subject to the fiduciary responsibility provisions (and therefore virtually a per se violation where "overfunding" exists which would result in a reversion) would be contrary to announced DOL policy. See Pension Funding Problems: Hearing Before the House Select Comm. on Aging 97th Congress, 2nd Sess. (1982) at pp. 122-127.

8/ Private plaintiffs argue that the Retirement Committee was on notice that the use of reverting assets contemplated by H&R's Board of Directors amounted to a breach of duties owed by the Directors to H&R. Not only are we unconvinced that the Retirement Committee had a duty to prevent such a breach, we are unaware of convincing evidence that such a breach took place.

former owners of the employer who sold their employer stock to the ESOP. In Eaves the conversion to an ESOP was a necessary part of the scheme to mask the looting of the plan through the purchase of overvalued employer stock. In the instant case, however, the defined benefit plan was not looted; all of the accrued benefits (with perhaps the exceptions discussed below) were paid to participants and a reversionary payment specifically authorized by the statute was made to the employer. The attempt to analogize the creation of the ESOP in Eaves and the creation of the ESOP here is fallacious. It ignores the fact that in Eaves the ESOP was created with plan assets which remained subject to the Act's fiduciary responsibility provisions, while in the instant situation the ESOP was created with funds that had, in a manner specifically permitted by ERISA, legitimately become corporate assets.

The Calhoun case merely holds that a welfare plan termination cannot result in the return of assets to a sponsoring employer, a holding obvious from the face of ERISA §403. The Court also concluded that an allegation that the plan's fiduciaries reduced benefits so as to create a surplus of assets that would not be used to pay benefits would state a claim under the fiduciary responsibility provisions of ERISA. Calhoun is distinguishable, first because it does not involve a defined benefit pension plan and thus the statutory provisions permitting the return of assets to the employer do not apply, and second, because there is no allegation in the instant case that the defined benefit plan's benefits were ever reduced. 9/

2. The lump sum distributions to plan participants.

Plaintiffs in the private litigation argue that the members of the Pension Fund's Retirement Committee breached their fiduciary duties by permitting the purchase of a group annuity contract which permitted Prudential to cash out participants whose benefits had a "present value" of less than $250.00,

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9/ As an alternative argument, private plaintiffs in one suit contend that even if the termination by the employer was legal, the defined benefit plan Retirement Committee had discretion to refuse to distribute plan assets under governing plan documents, that such refusal would have frustrated H&R's scheme, and that, as fiduciaries, they were obliged to frustrate that scheme if they had the power to do so. Under Title IV, however, distribution must be made promptly after receipt from PBGC of a Notice of Sufficiency. PBGC Opinion Letter 76-113, September 29, 1976.

where such present value was calculated using the same 15% actuarial assumption that Prudential used in preparing its bid for the group annuity contract. They make a similar allegation with respect to optional lump sum distributions offerred to participants whose benefits were valued between $250 and $1,000. 10/ We cannot support this view.

Section 4044(d)(1) of the Act provides that:

> Any residual assets of a single employer plan may be distributed to the employer if---
> (A) all liabilities of the plan to participants and their beneficiaries have been satisfied,
> (B) the distribution does not contravene any provision of law, and
> (C) the plan provides for such a distribution in these circumstances.

This section of the Act appears to give the PBGC authority to determine in the first instance whether "all liabilities... have been satisfied." Apparently construing this provision of §4044, PBGC has promulgated a regulation published at 29 C.F.R. 2619.26 which provides in pertinent part:

> (a) Applicability.
>
> A benefit that is payable as an annuity under the provisions of a plan need not be provided in annuity form if --
>
> * * *
>
> (2) The present value of the benefit determined under this paragraph, is $1750 or less...

10/ As noted *infra*, the decision to purchase the Prudential contract which provided for these lump sum distributions may have been made by the Committee's Chairman, without authorization by the Committee, in violation of the plan documents. Since the Chairman's decision has not questioned been by the Committee, and the decision, had it been made by the Committee would not have given rise to any liability, we do not believe that relief could be awarded based on the failure to follow the procedures in the plan document. In any event, this possible violation is being aggressively pursued in the private litigation.

(b) Valuation.

* * *

(2) The value of the lump sum or other alternative form of distribution payable under this section is the present value of the normal form of benefit provided by the plan payable at normal retirement age, determined as of the date of distribution using reasonable actuarial assumptions as to interest and mortality....

(c) Actuarial assumptions.

(1) The plan administrator shall specify the actuarial assumptions used to determine the value calculated under paragraph (b) of this section when the plan administrator submits the benefit valuation data to the PBGC pursuant to 2617.12 of Part 2617 of this chapter. The same actuarial assumptions shall be used for all such calculations. The PBGC reserves the right to review the actuarial assumptions used and to re-value the benefits determined by the plan administrator if the actuarial assumptions are found to be unreasonable.

(2) The following interest assumptions are among those that will normally be considered reasonable.

(i) The rate used by the plan for determining lump sum amounts prior to the date of termination. This rate may appear in the plan documents or may be inferred from recent plan practice.

(ii) The rate used by the insurer in the qualifying bid under which the plan administrator will purchase annuities not being paid as a lump sum. (In the event the insurer does not provide the specific rate used, the rate may be estimated.)

(iii) The interest rate used for the minimum funding standard account pursuant to section 302 of the Act and section 412(b) of the Internal Revenue Code.

(iv) The PBGC interest rate for immediate annuities in effect on the valuation date set forth in Appendix B to this part.

Accordingly, PBGC requires the interest assumptions referred to above to be submitted along with the plan's benefit valuation data. In the instant case, PBGC initially issued a notice of sufficiency after being apprised of the Prudential bid which assumed certain lump sum cash outs.

Moreover, PBGC was eventually made aware of all of the circumstances of the termination, including the lump sum distributions and the actuarial assumptions used, and has declined to exercise its right under the regulation to re-value the benefits determined by the plan administrator. In our view, PBGC's regulation, together with its decision to approve the termination without re-valuing the benefits, forecloses any argument by the Department that the participants receiving the lump sum did not receive everything to which they were entitled under the plan. 11/

11/ We note also that the IRS has adopted the PBGC calculation method for purposes of determining whether a terminating plan is entitled to keep its tax qualification.

Revenue Ruling 80-229 provides in pertinent part:

> In the case of a terminating plan in which the value of plan assets as of the date of termination is not less than the present value of all accrued benefits (whether or not nonforfeitable) as of such date, a distribution of assets to each participant equal to the present value of that

[continued on next page]

We are aware from conversations with PBGC staff that proposals are being circulated within PBGC to clarify, amend, or repeal their regulation. Therefore, prior to announcing the view being expressed here outside of the Department, further discussions should be held with the PBGC to assure that our positions remain consistent.

3. The amendment of the profit sharing plan.

The threshold question relating to the H&R Profit Sharing Plan is whether the decision to amend the plan to permit the investment of up to 50% of its assets in employer securities was subject to the fiduciary liability provisions of ERISA. There is no question that a plan containing all of the provisions of the amended profit sharing plan is, as a general matter perfectly legal under ERISA. Correctly drafted, an eligible individual account plan may hold up to 100% of its assets in employer stock. The question presented here, however, is whether the decision to amend an existing plan with

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11/ continued:

> participant's accrued benefit will not be discriminatory within the meaning of section 401(a)(4) of the Code if the formula for computing benefits as of the date of termination would not be discriminatory had the plan not terminated. All present values and the value of plan assets are computed using assumptions that are acceptable to satisfy section 4044 of ERISA.
>
> If the assets as of the date of termination exceed the present value of the accrued benefits (whether or not nonforfeitable) as of such date, the plan will not be considered discriminatory if such excess reverts to the employer.... [Emphasis supplied]

Although a pre-ERISA ruling, Revenue Ruling 71-152 (1971-1C.B. 127) suggests the opposite result, at least with respect to the deductibility of contributions to a trust in excess of that necessary to fund benefits provided on termination, IRS has informed the House Select Committee on Aging of its intent to revise 71-152 in light of the PBGC regulations quoted in the text.

restrictive limitations to permit a higher percentage of investment in employer securities is subject to §404 of ERISA, particularly where the amendment permits the plan fiduciaries to re-invest existing plan assets more heavily in employer securities.

There is some authority for the proposition that the decision to promulgate such an amendment is itself subject to ERISA §404. The Court of Appeals in Eaves v. Penn, supra, taking a position not advanced by the Department (which was a party plaintiff), held that the decision to amend the profit sharing plan in that case to make it an ESOP was subject to the fiduciary requirements of ERISA. Specifically, the Court held that the defendant,

> ...in recommending, designing and implementing amendment of the profit sharing plan to an employee stock ownership plan, acted in a fiduciary capacity under the Act.

Further support for this proposition appears to be present in the Department's ESOP regulations promulgated pursuant to ERISA §406(d)(6), which provide in pertinent part:

> (5) Conversion of existing plan to an ESOP. If an existing pension, profit sharing, or stock bonus plan is converted into an ESOP, the requirements of section 404 of the Act, relating to fiduciary duties and section 401(a) of the Internal Revenue Code (the Code), relating to requirements for plans established for the exclusive benefit of employees, apply to such conversion. A conversion may constitute a termination of an existing plan.... 29 C.F.R. §2550.407d-6.

However, the Deputy Administrator, who was the drafter of this provision, has advised us that the regulation was only intended to emphasize that §404 would continue to govern fiduciary investment decisions after the conversion of a plan to an ESOP. 12/

12/ It should be noted that the regulation not does apply directly to this case in that the H&R profit sharing plan was not converted to an ESOP. Rather, the profit sharing plan was amended to authorize a larger percentage of investment in employer stock, a change with implications similar to an ESOP conversion.

Assuming arguendo that the fiduciary provisions of ERISA apply to a decision to amend a plan to increase the proportion of employer securities that it may legally hold, it is extremely difficult to formulate rules governing when such an amendment constitutes a breach. The facts in Eaves v. Penn, supra, present the easiest case. There the conversion to an ESOP was the first step in a pre-arranged scheme to loot the plan by causing it to purchase all of the stock in the company from parties in interest at inflated prices. 13/ A harder case involves the amendment of an existing plan to permit the acquisition and holding of more than ten percent of employer stock and the subsequent purchase by the plan of such stock at fair market value, especially if it is assumed that the amendment and purchase took place under circumstances creating no obvious benefit to the sponsoring company or any party in interest, other than the presumed increased involvement of the employees with the company. Even in such a "clean" case, plan assets are arguably placed at greater risk by losing the protections of the diversification provisions of ERISA, and the plan sponsor gains by obtaining a work force with a greater financial stake in the company. The plan amendment which paves the way for such a result can hardly be said to be enacted "solely in the interest" of the participants and beneficiaries, although in certain cases the participants and beneficiaries will in fact benefit from such an amendment. The Harper & Row facts lie somewhere in between. Here the employer received, or at least perceived that it had received, the added benefit of securing the company against a possible takeover attempt.

If such amendments (in contrast to the original establishment or final termination of a plan) are subject to ERISA's fiduciary liability provisions, then all amendments to employee benefit plans which authorize the reinvestment of existing plan assets in employer securities in a greater proportion than authorized by the original plan document would violate, at a minimum, ERISA's exclusive purpose rule. 14/ Such a position

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13/ Even in that case, however, the action which actually harmed the participants was not so much the plan amendment as the stock purchase itself.

14/ Moreover, if the making of plan amendments is to be generally considered a fiduciary function, all plan revisions will have to be tested against all of the Act's fiduciary standards, for we know of no way to limit this position to amendments permitting larger holdings of employer securities.

would be novel, and in our view, extremely difficult to sustain under the facts presented in this case.

Moreover, other provisions of the Act appear to foreclose our taking the position in this case that the act of amending the plan violated ERISA. Where the Secretary of the Treasury issues a determination letter regarding the tax qualified status of a plan, ERISA §3001(d) obligates the Secretary of Labor to

> "...accept the determination of the Secretary of the Treasury as prima facie evidence of initial compliance by the plan with the standards of parts 2, 3, and 4 of subtitle I of this Act. 15/

Based on the statutory language, the legislative history and the position taken by the Secretary and the Court in Donovan v. Shaw, 668 F.2d 98 (8th Cir. 1982), it appears that decisions about whether a plan's provisions facially comply with ERISA are committed to the Secretary of the Treasury. Affidavits submitted by former Administrator Lanoff and IRS Assistant Commissioner Winborne in Shaw explained that, in conformance with this provision, IRS exercises exclusive responsibility to determine whether a plan initially complies with ERISA, i.e. whether it complies on its face and assuming that representations made to the IRS in connection with a request for a determination letter are accurate, while Labor retains jurisdiction to determine whether the actual operation of a plan complies with Title I of ERISA. The issuance of the favorable determination letter regarding the amendment of the profit sharing plan thus appears to prevent the Department from asserting that the mere change in the terms of the plan violated the fiduciary provisions of the Act.

4. The purchase of stock by the profit sharing plan.

As explained in the preceding section, we are likely foreclosed from challenging the amendment of the profit sharing plan to permit the purchase of Harper & Row stock. We are not

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15/ ERISA §3001(b) provides the Secretary of Labor an opportunity to comment in advance on the issuance of such a determination letter if requested by ten affected employees. The Department did not comment in the instant case.

foreclosed, however, from challenging the purchase itself. Even though the plan permits such a purchase, the decision to purchase is, without doubt, subject to ERISA's fiduciary responsibility provisions.

The legal basis of such a challenge would necessarily be the exclusive purpose provision of ERISA §404(a)(1)(A). Given all of the surrounding circumstances, it would be possible to allege that the intent or purpose of the purchase was to aid in Harper & Row's overall scheme to make itself takeover-proof. This is, however, for several reasons an extremely unattractive case to seek judicial acceptance of this theory.

First, we note that no more than adequate consideration, i.e., the mean between the bid and asked price for the stock was paid by the plan. Second, we have no basis to challenge the prudence of the transaction. In making the decision to purchase, the Board appears to have relied on competent advice from an independent investment firm, Kidder, Peabody. This advice suggested that Harper & Row was under-priced at market. Moreover, we have no reason to believe that this advice was in any way unsound. Indeed, although the price of stock fell briefly following the purchase, the stock now sells for more than its market price at the time of the purchase by the plan. 16/

As a result, even if we could prove an "exclusive purpose" violation, it is unclear what relief a Court could order, since the plan has suffered no obvious injury, and no offending party has obtained a quantifiable benefit from the purchase that might be disgorged. Under the circumstances, it is possible that a Court would hold the purpose of benefiting the Corporation or existing management too attenuated to justify finding a violation. Even if a violation is found it would be impossible to justify monetary relief. Similarly, at least in the Second Circuit, we would be unable to obtain the appointment of an independent investment manager on the strength of such a violation. In the Grumman case, which presented much clearer violations of both ERISA §§404(a)(1)(A) and (B), and where the responsible fiduciaries caused large quantifiable losses to be suffered by the plan involved, the Second Circuit overturned Judge Mishler's appointment of an interim receiver as being unnecessary in the absence of an ongoing takeover attempt. Since no such attempt is occuring

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16/ The sale was at 11-5/8 on December 9, 1981. The closing bid and asked on March 2, 1983 was 13-13-3/8.

here, and since the potential violation is much less egregious than that proved in the Grumman case, appointment of an independent asset manager in Harper & Row would almost certainly be unavailable under the law as interpreted in the Second Circuit.

5. Establishment of the ESOP

Plaintiffs in the private litigation also challenge the establishment and funding of the ESOP as a violation of ERISA. Their contention appears to be, not that the ESOP's establishment or funding was illegal *per se*, but rather that it was rendered illegal because its establishment and funding was part of a plan or scheme to defraud the participants of the original defined benefit plan by convincing them that, notwithstanding the allegedly illegal termination of the defined benefit plan, their overall level of benefits had stayed the same or improved. We find no merit to this contention.

As explained above, H&R had no obligation to maintain a certain level of benefits, or to maintain in existence any particular employee benefit plan. The creation of employee benefit plans by employers and their maintenance is voluntary under the Act. To the extent that H&R management has "oversold" the ESOP to its employees, any resulting causes of action accruing to those employees do not arise under ERISA.

6. Action to prevent abuses in the event of a future takeover attempt.

By placing a third of the Company's stock in the ESOP and the profit sharing plan, subject to sale only with the approval of the Board of Directors, Harper & Row management has obtained the ability, absent the provisions of ERISA, to defeat any takeover attempt. If the world at large perceives that this power may be exercised legally, and independent of the interests of the plans involved, no company unfriendly to existing management will bother to tender for the stock. Although Harper & Row's management has obtained this power as the result of a publicly announced plan which had the defeat of potential hostile takeovers as one of its express aims, the resulting situation is not different from any company whose employee benefit plans own a large block of stock.

The Harper & Row case illustrates the need for the Department to continue to articulate its views regarding the use of plan assets in takeover fights. Although unlike the Grumman case, we have concluded that litigation by the Department is not an appropriate response, it remains most important that we make it clear to the world at large, as well as the responsible fiduciaries here, that the Department will not tolerate the partisan use of plan assets in takeover battles. In such a situation, an impartial fiduciary must be employed to evaluate and carry out a prudent course of action solely in the interest of the plan and its participants. We believe that the best way to accomplish this is not only private letters to the boards of directors of particular companies, but a public statement of this view by the Department.

CONCLUSION

No further action on the instant case is warranted at this time. It would be appropriate, however, for the Department to clarify its position publicly on the issue of whether and under what circumstances fiduciaries who are officials of a company subject to a takeover attempt may take part in a decision whether to tender plan stock. It would also be advisable to coordinate with PBGC regarding any revision of their regulations governing permissible actuarial assumptions in calculating lump sum benefit distributions.

U.S. Department of Labor [illegible]

Reply to the Attention of

August 3, 1982

TO: Charles M. Williamson, Acting Asst. Admin., OE

THRU: Charles L. Smith, RA, NYRO

FROM: Stephen Pine, ARA/PWBP, NYRO SPine

SUBJECT: Harper and Row Pension and Profit Sharing Plans - Case No. 30-10159 (48)

Attached you will find an Action ROI on subject plans along with the AA cover memo alleging violations of Act Sec 404(a)(1)(A),(B) 406(b)(1) and (b)(2) regarding the actions taken by Harper & Row (H&R) in preventing the sale of H&R on the open market by the Minneapolis Star Tribune Co. (MST).

The Regional Office is in agreement with this assessment.

However, before getting into an analysis of the H&R actions, we wish to point out some of the problems in dealing with the alleged violations. It is clear, that from the inception of the MST decision to sell its H&R stock (approximately 1/3 of all outstanding H&R shares), the H&R Board of Directors were determined to prevent the stock from going on the open market. In order to prevent this, the assets of both plans were used directly and indirectly to accomplish this goal.

The Board of Directors of H&R decided to fund the purchase of its stock as follows:

1) Terminate the pension plan and utilize the proceeds from its excess funding	$ 9.8 million
2) Sale of real property owned by H&R in Pennsylvania and New York	4.5 million
3) Amend the profit sharing plan to allow for purchase of H&R stock	1.5 million
4) Utilization of cash on hand and H&R line of credit for the balance	4.5 million
	$20.3 million

This resulted in the purchase of 1,017,630 MST shares at $20/share. The profit sharing plan purchased 152,585 of the MST shares on 12/9/81 at a price of $11.34/share. The remaining shares were contributed to an ESOP established in conjuction with the foregoing H&R strategy.

At each step in this purchase arrangement, H&R performed those actions required by statute. For example, with respect to the Pension Plan, termination was requested and approved by IRS and also approved by the PBGC which issued a notice of sufficiency. The profit sharing plan was amended to allow for purchases of H&R stock for up to 50% of the portfolio and plan participants were given an opportunity to withdraw their contributions prior to the consummation of the purchase. The appearance thus far leads one to conclude that they are in compliance with applicable statutes.

However, the interviews conducted and the proxy statement for the stockholders meeting of 12/9/81 makes it clear that the decisions involving the employee benefit plans and MST shares of H&R stock were "...in the best interest of the corporation and its stockholders...", exh. 4 pgs. 7 & 8.

It is clear from IB 2509.75-8 that the Board of Directors of Harper and Row are fiduciaries with respect to both plans. They made the decision to terminate the pension plan and establish an ESOP in its stead and to amend the profit sharing plan.

We believe that this case parallels the Grumman case (Donovan v. Bierwirth et al) in that employee benefit plan assets were utilized for corporate purposes and that a 406(b)(2) violation exists. Although Judge Mishler ruled that the Grumman situation was not a per se violation of 406(b)(2) and that it would have to be proven, we believe that such a violation can be established given the facts presented here.

In addition, we believe that the Trustees were imprudent in taking a well funded plan with a well diversified portfolio and in effect putting their eggs in one basket (H&R stock). Proposed regulation 2550.401b-1(a) defines plan assets in such a manner that it may be construed that at all times the assets of the pension plan remained plan assets and merely the composition has been changed. It is clear that at all times it was intended that proceeds of the termination would be utilized to purchase H&R stock which would be contributed to a Harper & Row ESOP. Therefore, the assets of the pension plan were to be used to provide plan benefits whether as originally constituted or as H&R stock.

We believe that Eaves v. Penn can also be cited with regard to this case. In that case, it was ruled that while a fiduciary may be released from per se violations on investments in employer securities under provisions of Secs 406 and 407 of ERISA any investment decision is governed by the "Solely in the interest" and"prudence" tests of Secs 404(a)(1)(A) and (B).

As for a remedy to the violations, we are in the same position as the area office. There is not a simple answer. This is not a prohibited transaction case where rescision of the transaction is appropriate nor is there a demonstrable loss for which the Trustees can be held liable. The end result of any action taken by DOL should result in the participants being in a position at least as favorable as that before the manipulation accurred.

It should be noted that the Area Office was requested to obtain additional information on subject case after it was reviewed at the RO. This will be sent directly to OE upon receipt.

Items requested include:

1) Prudential contract
2) Kidder, Peabody study
3) Copy of ESOP Trust Agreement
4) Interview with Irving Trust to determine why they resigned as trustees to the profit sharing plan.
5) Documentation of price of H&R stock as of 12/9/81.
6) Rest of exhibit 18.

In addition, the investigator interviewed complainant Glen Howard.

ITED STATES GOVERN

Memorandum

: Charles L. Smith, RA/NYRO **DATE:** July 6, 1982

ROM : George L. Nash, AA/NYAO

UBJECT: Harper & Row Pension & Profit Sharing Plans
Case No. 30-10159

Transmitted herewith is Action ROI by Investigator S. KUSIEL regarding Subject Plans detailing fiduciary breaches in connection with the termination of the H & R Pension Plan and the amendment of the Profit Sharing Plan. These actions were taken to assist in the financing of Harper & Row's acquisition of H & R common stock from Minneapolis Star Tribune Company, the then largest single shareholder of H & R stock. It is clear that H & R purchased the stock to insure that the MST shares were not purchased by another company which would then have a controlling interest in H & R. Using the employee pension benefit plans for this reason, then, is not in the interests of participants but rather is in the interests of the plan sponsor. Had the plans not been used for the stock purchases H & R employees would have continued to accrue benefits that are definitely determinable and in the case of the pension plan.their retirement income would have been insured by the PBGC. Under the H & R reorganization of the plans, employee benefits now take the form of an interest in H & R Stock maintained in the newly created Employee Stock Ownership Plan. Their pensions are dependent on the performance of the company. Moreover, Harper & Row has no commitment to make plan contribution following the placement of the shares of stock bought by H & R from MST into the profit sharing & ESOP Plans.

The above transactions, therefore, are self serving steps taken by the H & R Board of Directors in violation of Sections 404 (a) (1), 404 (a) (1) (B), 406 (b) (1), and 406 (b) (2) Title I ERISA. Fashioning an equitable remedy, however, poses a difficult problem inasmuch as the major plan in question has already been terminated with PBGC's notice of sufficiency. In light of this and other factors (including the plublicity this matter has received in the news media) I believe that National Office DOE/PWBP guidance is necessary in this case as to what course of enforcement action should be taken to remedy the infractions.

lp

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It should be noted that a civil complaint has been filed in the SDNY by participants in Subject plans alleging violations of ERISA Title I (and other federal statutes). The complaint focuses on the termination of the pension plan and asserts that lump sum distributions paid to participants in the pension plan in settlement of their pension entitlement represent less than the true value of their accrued benefits. The filing maintains that Prudential Insurance Company in calculating the amount of the lump sum payments is using an inordinate 15% interest assumption under its contract with H & R to cover the termination liability of the plan. The suit also cites the infractions that are the basis of the NYAO investigation.

This case originated with the submission of a complaint by an H & R shareholder in December of last year. Knowledge of the issues investigated date from then and therefore the matter is timely per Section 413 Title I.

U.S. DEPARTMENT OF LABOR Labor-Management Services Administration	REPORT OF INVESTIGATION	FILE NO.: 30-10159
SUBJECT: Harper & Row, Publishers, Inc. Retirement & Profit Sharing Plans 10 East 53rd Street EIN: 13-1966132 -001-002	PROGRAM: 48 VIOLATION(S):	DATE: 7/2/82 BY: Inv. S. Kusiel AT: NYAO STATUS: Action

SYNOPSIS:

I. Predication

Investigation predicated upon receipt of a complaint alleging fiduciary impropriety in the termination of Subject pension plan and the amendment of Subject profit sharing plan for the purpose of facilitating the purchase of employer stock by the plan sponsor.

Case was opened on 12/7/81 and investigation commenced immediately thereafter. The information the NYAO received indicating possible fiduciary violations took the form of a proxy statement outling, among other things, H & R proposals to revise its employee pension benefit plans. The statement was sent to the NYAO by an H & R shareholder and arrived in early December, 1981.

II. Potential Jurisdictional Problems

None

Requests for Variances

None

III. Background

The following plan administration & financial data briefly describe the Plans as of 4/30/80. The alleged fiduciary breaches in this case concern the termination of the Pension Plan and the amendment of the Profit Sharing Plan to finance the purchase of Harper and Row stock. Therefore, the following information outlines the plans as they were prior to the asserted infractions which occurred in 1981.

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LMSA 200 (1/76)

Subject pension plan is a tax qualified, non-contributory, unilateral defined benefit retirement fund covering employees of Harper & Row Publishers, Inc, and its participating subsidiaries (Exh. 1 Schedule A). The latter are Basic Books Inc., 10 East 53rd Street, New York, N.Y. 10027; Ballinger Publishing Co., 17 Dunster Street, Cambridge, Massachusetts 02138; and J.B. Lippincott Company, East Washington Square, Philadelphia, Pennsylvania 19105. Some employees of Harper & Row participating in the Plan are represented by labor organizations which are as follows: (Exh. 21, Page 10; Exh. 22 Page 16).

The Association of Harper & Row
Employees, affiliated with District 65
(Publishing Local, District 65), United
Auto Workers (U.A.W.) 10 East 53rd Street,
New York, N.Y. 10022

Harper & Row Sales Assiciation
c/o ARTHUR E. BURGESS
Box 80, Rural Route 2
Stony Point, N.Y. 10980

Harper & Row Inc. adopted the Plan effective May 1, 1963 in New York (Exh. 1, Page 2). The Basic benefit is a life annuity payable at age 65 calculated on the basis of a unit credit formula od 1 1/3 of Employee Earnings (highest average annual earnings over five years LESS 1 1/3 of Primary Social Security benefits multiplied by up to 30 years of credited service (Exh. 1, Article III). The Plan also provides early retirement pensions payable at age 55 to participants with at least ten years of service, and vested Retirement Income benefits per the ten year schedule is paid to employees who terminate employment having completed at least ten years of service (Exh. 1, Sections 3.03 & 5.01). Additionally, the plan includes pre and post-retirement death benefits depending upon participant election (Exh. 1, Section 3.04)

Subject Profit Sharing Fund is a tax qualified unilateral defined contribution Plan covering employees of Harper & Row Inc. and its participating subsidiaries (Exh. 2, Sched. A). It was adopted effective 5/1/63 in New York (Exh. 2, page 2). Harper and Row contributes annually an amount equal to 10% of net income subject to the following limitations (Exh. 2, Section 3.01)

1) The contribution may not exceed deductible limits of the IRC (15% covered compensation).

2) The contribution may not exceed the difference between net income and dividends declared during the year.

The contribution is allocated among the employees in the proportion that the compensation of each participant bears to total covered compensation of all participants (Exh. 2, Section 3.01). Also, participants may make voluntary contributions of up to 10% of compensation (Exh. 2, Section 3.02). Participants vest in employer contributions after three years of service and vest immediately in their own contribution (Exh. 2, Section 7.01). Forfeitures are reallocated among remaining participants and participants are allowed to withdraw annually their vested account balance (Exh. 2, Section 7.01, 7.02, 6.15). Both employer and employee contributions are invested at the direction of each participant in either a fixed income or Equity Fund. (Exh. 2, Section 4.02)

IV. Plan Administration & Financial Operation

Subject Pension Plan is administered by a "Retirement Plan Committee" whose members are appointed by the Board of Directors of Harper & Row Inc. (Exh. 1, Section 7.01). Prior to 12/9/81 the members of the Committee were as follows:

NORMAN L. CANNON - Chairman
JANE ISAY
CHESTER S. LOGAN
EDWARD A. MILLER
NORMAN POMERANCE

As of 1/6/82 the members are as follows (Exh. 3)

NORMAN L. CANNON, Chairman
HOWARD S. AKSON
EDWARD A. HUTTON
JANE ISAY
CHESTER S. LOGAN
EDWARD A. MILLER
NORMAN POMERANCE
ROBERT L. SPENCE

The Committee is responsible for the operation and administration of the plan and constitutes the plan administrator (as per Section 3 (16) Title I ERISA (Exh. 23). The Committee's authority includes the power to interpret or construe the plan; to determine all questions of eligibility status and rights of participants, and to decide any dispute arising under the plan (Exh. 1. Section 7.03). The Committee also has the authority to direct the trustee concerning plan payments. Committee members are entitled to reimbursement by Harper & Row Inc. for expenses incurred in carrying out their duties as committee members (Exh. 1, Section 7.04). Authority to amend the Plan is vested in the Board of Directors of Harper & Row Inc. (Exh. 1, Section 8.01).

Plan assets are held in a Trust Account maintained at and are invested by Morgan Guaranty Trust Company of New York. Subject's accountant is Arthur Anderson and Company, 1345 Avenue of the America's, N.Y. N.Y. Actuarial Services are provided by the firm of Towers, Perrin Forster & Crosby, 600 Third Avenue, New York, N.Y. 10016. The Plan's administrative expenses are paid by Harper & Row Inc.

Contributions to the Plan are made by Harper & Row based upon actuarial determinations made by the fund's actuary. There is no provision for employee contributions. (Exh. 1, Sections 4.01 & 4.02)

Subject Profit Sharing Plan is administered by the Profit Sharing Plan Committee which is appointed by the Board of Directors (Exh. 2, Section 8.01). The members of the Committee and the above Pension Plan Committee are identical (Exh. 3). The Committee is charged with the operation and administration of the Plan and constitutes the plan administrator (as per Section 3(16) Title I ERISA (Exh. 24). The Committee's authority includes the power to interpret or construe the plan, to determine all questions of eligibility, status and rights of participants, and to direct the Trustee to make payments from the Fund pursuent to provisions of the plan (Exh. 2, Section 8.03). Committee members are reimbursed by Harper & Row Inc. for expenditures incurred in carrying out their duties as Committee members (Exh. 2, Section 8.04)

Authority to amend the plan is vested in the Board of Directors of Harper & Row Inc. (Exh. 2, Section 9.01).

Accounting services are provided by Arthur Anderson & Company.

Until 8/1/80 the funds' assets were held in a Trust Account maintained at the Chase Manhatten Bank, N.A. On 9/5/80 Subjects' assets were transferred to the Irving Trust Company. Effective 11/30/81 Irving Trust Company resigned as Trustee and the Plans assets were transferred to a Trust Account at Manufacturers Hanover Trust Company.

Contributions (both employer and employee) until 12/1/81 were invested at the direction of each participant in either a Fixed Income or Equity Fund (Exh. 2, Section 4.02). Alternately, each participant could split his contribution between the two Funds in multiples of 25% (Exh. 2, Section 4.02). The Funds until 11/30/81 were managed by Wright Investor Services, 500 State Street, Bridgeport, Connecticut.

As more fully explained below, the fund was amended in October, 1981 in connection with the purchase of Harper & Row stock by the plan sponsor. As a result of the amendment, the two investment funds were eliminated.

V. Alleged violations of Sections 403 (a) (1); 406 (b) (1) & (2); 404 (a) (1); 404 (a) (1) (A) & 404 (a) (1) & (B)

The instant case arises from the use of subject plans to facilitate the purchase of Harper & Row common stock by the plan sponsor from the Minneapolis Star & Tribune Company (hereinafter MST). Investigation discloses that in February, 1981 the single largest H & R shareholder, MST, advised Harper & Row that it was going to dispose of its stock holdings of 1,017,630 shares of H & R common stock (hereinafter MST shares) which constituted about one third of the then outstanding 3,068,323 shares of H & R common stock and represented the single largest shareholding of H & R stock. Harper & Row's Board of Directors (hereinafter the Board) in light of the substantial size of the block of MST shares & the potential effect of its disposition on control of H & R considered a number of options including 1) assisting MST in finding a buyer 2) trying to arrange a merger of H & R and, 3) a Harper & Row purchase of the shares (Exh. 4, Pages 1, 7). In its evaluation of the options the Board was guided by the following: (Exh. 4, Page 7)

a) The Board's view that H & R stock was undervalued based on business prospects for H & R

b) Editorial independence could be jeopardized by outside control

c) The continued availability for purchase of MST shares would create uncertainty detrimental to H & R.

The Board also saw in an H & R purchase of the shares the opportunity to revamp its employee pension benefit plans in such a way that the corporations business would be furthered by giving employees an interest in the company (Exh. 4, Page 8). The Board concluded that the interests of the company would be best served by H & R buying the MST shares and the attendant restructuring of the pension plans to assist in financing the purchase (Exh. 4, Page 8). H & R then proceeded to negotiate an agreement with MST for the purchase of the MST shares. Agreement was reached on 8/4/81 and was approved by H & R Board of Directors on 9/15/81 (Exh. 4, Page 8).

The agreement provided that H & R would buy the MST shares for approximately 20.4 million dollars. Although not required by law, the Board decided to present the Agreement to the shareholders for approval (Exh. 4, Page 8). The Agreement including the preposed reorganization of the employee benefit plans was approved at the 12/9/81 H & R shareholders meeting (Exhs. 17, 25)

In anticipation of approval of the Purchase Agreement, H & R by vote of the Board terminated Subject pension plan effective 8/31/81 (Exh. 25). Notice of Intent to Terminate the plan was filed with the Pension Benefit Guaranty Corp. (Exh. 7). The Corporation issued a notice of sufficiency to H & R (Exh. 9). H & R also applied to IRS/EPEO for approval of the determination (Exh. 8). IRS responded with a favorable determination (Exh. 10). Under both the Pre-ERISA and amended Plan provisions, plan assets in excess of funding required to provide all accrued benefits are to revert to the sponsor on plan termination (Exhs. 1, Section 9.05;5) H & R, in connection with the Purchase Agreement estimated that the excess funding amounted to 9.8 million dollars (of the total plan corpus of 16.4 million dollars)based upon a quotation from the Prudential Insurance Company (Exh. 4, Page 11). The carrier indicated that the present value of the accrued liability for benefits to date of termination could be provided for a premium of $6,423,000 which would cover benefits in the form of lump sum distributions and paid up annuity contracts. This fugure is less than the termination liability reflected in the most recent Actuarial Valuation (Exh. 26, Pages 5 & 6).

Also, in connection with the Purchase Agreement, the H & R Board amended the provision of Subject Profit Sharing Plan (Exhs. 15, 16, 17 & 4, Page 11). Under the terms of the Amendments, the Plan was converted into an "eligible individual account plan" (per Section 407 (d) (3) Title I ERISA) that allows investment of up to 50% of Plan Assets in qualifying employer securities and qualifying employer real property (Sections 407 (d) (5) & 407 (d) (4), respectively) (Exh. 11). H & R also proposed to liquidate the Plans Equity Fixed Income Investment Funds A & B of the Pre Amended Trust (Exhs. 15, 16, 17). H & R further amended the plan to provide for discretionary employer contributions whereas the pre-amended plan required annual contributions in the amount of 10% of corporate net income (Exhs. 2, Sect. 3.01; Exh. 11, Sec.3.01) H & R submitted the amendments to IRS/EPEO (Exh. 12). IRS issued a favorable determination letter (Exh. 13).

Additionally, the amendments provided for annual deductable employee contributions of up to $2,000 to the plan as provided under the 1981 Economic Recovery Tax Act (Exh. 11, Section 1.31). Finally, participants were given the option of withdrawing their vested account balance prior to plan amendment without penalty (Exh. 18). H & R estimated that participants would withdraw $1,000,000 but in fact they withdrew approximately $400,000 (Exh. 25).

Further, in the restructuring of H & R employee pension benefit plans, H & R adopted an "Employee Stock Plan" effective May 1, 1981 (Exhs. 4, Page 16, 20). The fund is a stock bonus plan designed to receive deductible contributions of the MST shares obtained under the Purchase Agreement (other than the portion of the MST shares to be pruchased by the Profit Sharing Plan) (Exh. 4, Page 16, Exhibit C). Although plan provisions would allow future contributions of H&R securities and/or cash, H & R is not obligated to make plan contributions other than the MST shares (Exh. 4, Page 16). Under the stock plan's allocation formula, participants would receive accruals of H & R stock projected to equal benefits they would have accrued under the H & R pension and prior (unamended) Profit Sharing Plans for the period from 9/1/81 to 5/1/86. H & R acknowledges that benefits from the stock plan may not equal the projected sums if the price of the stock falls from the assumed $13.00 per share value in the calculation of the value of the stock benefit (Exh. 4, Page 16, Exh. C & Schedule A).

The above plan termination, plan amendments and establishment of the new Stock Plan were undertaken as part of H & R's purchase of the MST shares. Following shareholder approval of the Purchase Agreement, Subject profit sharing plan on 12/9/81 purchased 152,585 shares of the MST shares for $1,783,337, or $11.34 per share. The price represents the mean between bid and asked price for the stock as of close of business on 12/8/81 (Exh. 25). No fees or commission were paid by the plans in connection with the sale (Exh. 25). To terminate the pension plan as indicated above, H & R entered into a group contract with Prudential to cover plan benefits and the sum of 9.8 million dollars reverted to H & R which was used to purchase additional MST shares of H & R stock (Exh. 25).

The balance of the 20.4 million dollar purchase per the Purchase Agreement was provided by cash on hand, borrowings under lines of bank credit and proceeds of the sale of real properties owned by the company (Exh. 4, Pag 10). The plans provided their slightly more than 1/2 of the purchase price paid by H & R for the MST shares.

U.S. Department of Labor
Labor-Management Services Administration
Washington, D.C. 20216

Reply to the Attention of:

Mr. Michael S. Gordon
Mittelman and Gordon
1747 Pennsylvania Avenue, N.W.
Suite 704
Washington, D.C. 20006

Dear Mr. Gordon:

Thank you for your letter of August 10, 1982 concerning the Department's investigation of the Harper and Row Publisher's Inc., Employee Stock Plan. Your letter expresses your particular concern with the fact that the Internal Revenue Service issued a favorable determination letter with respect to the plan's tax qualified status under the Internal Revenue Code while the Department's investigation was ongoing.

If I understand your letter correctly, you are suggesting that the issuance of a favorable determination letter by the IRS could create problems for the Department in any future enforcement proceeding that may be instituted as a result of our investigation into the circumstances relating to the termination of the Harper and Row Retirement Plan. In order to prevent this from occurring, you urge that the Department request the IRS to inform Harper and Row that the subject favorable determination letter is under review by the IRS National Office and, pending completion of the Department's investigation, may be revoked. Your letter also recommends that the IRS adopt a procedure under which it would suspend action on determination letter requests if a Department of Labor investigation is pending.

I appreciate your concern that future enforcement actions undertaken by the Department may be hampered. I do not, however, agree that the issuance of a favorable determination letter with respect to the tax qualification of a newly established plan would in any way inhibit our enforcement efforts with respect to other plans of the corporate sponsor. Nothing that I am aware of in ERISA suggests to me that, as a matter of law, DOL enforcement actions in such circumstances would be adversely affected by the existence of an IRS determination letter. Furthermore, as a practical matter, our investigations can sometimes be lengthy and subsequent enforcement proceedings are subject to all of the delays in the judicial process. In my view, urging the IRS to suspend action in such cases would serve no useful purpose and would not be a significant aid to the Department in its enforcement efforts.

I appreciate receiving your views on this subject and hope this response is satisfactory.

Sincerely,

Jeffrey N. Clayton
Administrator
Pension and Welfare
Benefit Programs

Rewritten: LMSA:PWBP:OFS:ADLebowitz:mer:9/23/82
C-4526 FPB x37461

cc: Clayton (2)
Chron
Enforcement (30-10159)
New York AO
New York RO

Garofolo

AUG 31 1982

MEMORANDUM FOR: JEFFREY N. CLAYTON
Administrator, PWBP

FROM: CHARLES M. WILLIAMSON
Acting Assistant Administrator
for Enforcement, PWBP

SUBJECT: Letter From Michael S. Gordon
RE: Harper and Row Publishers, Inc., Employee Stock Plan
Case No. 30-10159

Attached is a draft letter which indicates how we believe the Department should respond to Mr. Gordon's letter dated August 10, 1982.

With respect to the status of the Harper and Row investigation, we have completed our analysis of the Report of Investigation submitted by the New York Region. Based on this analysis, we are preparing a memorandum to the Solicitor which requests their opinion in regard to the best case which can be made for a Departmental finding that the fiduciaries violated sections 404(a)(1)(A), 404(a)(1)(B) and 406(b)(1) and 406(b)(2). Simultaneously, we are requesting that the New York Region conduct additional investigation (primarily interviews) in order to assist this office and the Solicitor in rendering a determination with respect to whether violations have occurred.

If you would like to be briefed further on the Harper and Row investigation or would like to discuss the proposed response to Mr. Gordon, please advise.

Attachment

cc: ✓Enforcement   Chron   New York RO

LMSA:PWBP:ENFORCEMENT:DFSI:GAROFOLO:ccm
8/24/82 N4720 38834

OFFICE SYMBOL	INITIALS	DATE
DFSI		8/29/82
DFSI		[illegible]
OE		8/31/82

APR -7

MEMORANDUM FOR: CHARLES M. WILLIAMSON
Assistant Administrator
for Enforcement, PWBP

FROM: LEONARD L. GAROFOLO
Regional Coordinator, OE

SUBJECT: Harper and Row Plans
Case No. 30-10159

A review of New York Region and Area Office memoranda dated August 3, 1982 and July 6, 1982, which transmitted the ROI to OE in the above subject case, indicates a belief that prudence and self dealing violations have occurred and enforcement action is necessary. With respect to the type of enforcement action necessary, the memoranda state that ". . . fashioning an equitable remedy . . poses a difficult problem. . ." and OE "guidance is necessary in this case as to what course of enforcement action should be taken to remedy the infractions."

As you are aware, OE transmitted the subject case to SOL on September 10, 1982 and requested that an analysis and opinion be provided with respect to the "best legal argument" for finding that fiduciary violations occurred.

cc: Chron
Enforcement
✓Kennelly

LMSA:PWBP:ENFORCEMENT:DFSI:GAROFOLO:ccm
4/7/83 N4720 38834

[illegible] 15 198

MEMORANDUM FOR: ROBERT N. ECCLES
Acting Associate Solicitor, PBSD

FROM: CHARLES M. WILLIAMSON
Acting Assistant Administrator
for Enforcement, PWBP

SUBJECT: Harper and Row Publishers, Inc.
New York, New York
Case No. 30-10159(48)

Attached for your consideration is additional evidence submitted by our New York Area Office relating to the above subject case which was referred to you on September 10, 1982. All of the evidence relates to the role the Irving Trust Company played as a trustee for the Harper and Row Profit Sharing Plan and the reasons for its resignation. The evidence consists of the following documents:

1. Report of Interview dated September 23, 1982, of Irving Trust Company officials.

2. A letter with attachments dated September 28, 1982, from Irving Trust Company to New York Area Office.

Our review of this evidence indicates that the Irving Trust Company (ITC) was a trustee for the profit sharing plan from September 1, 1960, to December 1, 1981, and that the trustee resigned because the plan was being amended to acquire the Harper and Row stock which was being purchased from the Minnesota Star and Tribune Company. Particularly of interest with respect to the resignation is the attached internal ITC memorandum dated November 10, 1981, which indicates that the resignation was caused by ITC's fear of being sued as a result of the profit sharing plan's "new investment policy." The internal memorandum also indicates that the ITC decided to resign, at least in part, because of the O'Neill v. Marriot Corporation and Donovan v. Bierwirth litigation.

At this time, we are still awaiting additional evidence which is currently being obtained by the New York Area Office and we will transmit this evidence upon our receipt. If you have any questions in regard to the attached, please contact me or Mr. Garofolo of my staff.

Attachments

cc: Enforcement
Chron
New York AO
New York RO
SOL Referral
Clayton Info

LMSA:PWBP:ENFORCEMENT:DFSI:LGAROFOLO:CAW
10-13-82 N4720 Ext. 38834

Irving Trust

Roy T Ortman
Vice President

Irving Trust Company
One Wall Street
New York, NY 10015

Mr. Stephen Kusiel
U.S. Department of Labor, LMSA
Pension Welfare Benefit Programs
26 Federal Plaza, Room 537
New York, NY 10278

September 28, 1982

Re: Harper & Row Profit-Sharing Trust

Dear Mr. Kusiel:

As you requested on September 23, enclosed is the following material from our files in connection with Harper & Row Profit-Sharing Trust:

1. A photocopy of the Trust Agreement dated September 1, 1980, between Harper & Row and Irving Trust Company.
2. A photocopy of our fee letter dated August 29, 1980.
3. A photocopy of two letters dated October 2, 1981, one of which is our formal resignation as Trustee of the Profit-Sharing Trust.
4. A photocopy of an internal memo dated November 10, 1981, providing some background information in connection with our resignation.

You also inquired about the precise dates of our Trusteeship of the Harper Row Profit-Sharing Trust. The period of our involvement was September 1, 1980, to December 1, 1981, which is the date Manufacturers Hanover Trust Company accepted its responsibilities as Successor Trustee (see enclosed photocopy of "Notice of Acceptance" dated December 3, 1981).

Sincerely yours,

Roy T Ortman

Roy T. Ortman
Vice President

cc: Ted Miller, Legal Department
Harper Row, Publishers, Inc.
10 East 53 Street
New York, NY 10022

H

WEIL, GOTSHAL & MANGES
A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS
767 FIFTH AVENUE · NEW YORK, N.Y. 10153
(212) 310-8000

TELECOPIER: (212) 752-3978
CABLE: WEGOMA
TELEX: ITT 424281
TELEX: ITT 423144
WRITER'S DIRECT LINE
(212) 310-8638

WASHINGTON OFFICE
1101 CONNECTICUT AVENUE, N.W.
WASHINGTON, D.C. 20036
(212) 431-6820
(202) 857-0141
TELECOPIER: (202) 857-0184
TELEX: ITT 440045

FLORIDA OFFICE
800 BRICKELL AVENUE
MIAMI, FLORIDA 33131
(305) 579-9500
TELECOPIER: (305) 374-7159

September 30, 1982

BY HAND

Mr. Stephen Kusiel
U.S. Department of Labor, LMSA
Pension Welfare Benefit Programs
26 Federal Plaza, Room 537
New York, New York 10278

Re: Harper & Row, Publishers, Inc.

Dear Mr. Kusiel:

Per your request of Ted Miller, enclosed are copies of minutes of Harper & Row's board of directors, audit committee and plan committee for the period from February 1981 through January 1982. We have redacted irrelevant material.

Sincerely,

Nancy E. Barton

Nancy E. Barton

NEB:mm
Enc.

U.S. DEPARTMENT OF LABOR
Labor-Management Services Administration

REPORT OF INTERVIEW

Date of Interview September 23, 1982

On the above date the writer interviewed ROY T. ORTMAN, Vice-President, and MARY LEON PANETTA, Administrative Officer, Trust Department Irving Trust Company, at their office, 1 Wall Street, New York, N.Y. They were advised that the writer is conducting an official investigation for the Pension and Welfare Benefit Programs, Labor-Management Services Administration, U.S. Department of Labor, pursuant to the ERISA. They were further advised that the writer was requesting their cooperation.

ORTMAN advised that Irving Trust had the Harper & Row Profit Sharing account from about January, 1980 to November, 1981. The account was handled by CARL BETZ, a former Investment Account Executive currently with another bank, and PANETTA served as the accounts Administrative officer.

Irving Trust resigned the account when the Harper & Row plan was amended to provide for substantial investment of fund assets in Harper & Row stock. ORTMAN stated that both the Bank's in house and outside counsels advised that Irving Trust might well be sued as a result of the plan's new investment policy and he recalls that one of the attorneys mentioned the Marriott case as well as others as examples of litigation arising from plans investing in their sponsor's stock. ORTMAN mentioned that the Harper Plan was a small account and therefore the Bank did not earn very much from serving as its Trustee.

ORTMAN said he would furnish DOL with copies of its Trust & fee arrangement with Harper & Row as well as copies of correspondance and any other documentation concerning the above.

S. K.

By Investigator Stephen Kusiel

At NYAO

lp

Date Dictated 9/23/82

Date Transcribed 9/30/82

File No. 30-10159 (48)

This document is the property of the Labor-Management Services Administration
Its contents are not to be disclosed to unauthorized persons.

LMSA 228 (/73)
GPO 920-511

AGREEMENT OF TRUST

THIS AGREEMENT made as of the 1st day of September, 1980, by and between HARPER & ROW, PUBLISHERS, INC., a corporation of the State of Delaware, hereinafter referred to as the "Company," and IRVING TRUST COMPANY, a corporation of the State of New York, hereinafter referred to as the "Trustee;"

WITNESSETH:

WHEREAS, the Company (and certain of its subsidiaries) has heretofore adopted the Harper & Row, Publishers, Inc. Profit-Sharing Plan (a copy of which is filed herewith and is hereinafter called the "Plan") and desires Irving Trust Company to act as Trustee thereunder; and

WHEREAS, heretofore, the Company had established a trust for the funding of the Plan with Chase Manhattan Bank, N. A. (hereinafter referred to as "Chase") as trustee, under agreement dated October 10, 1969, as amended and restated as of May 1, 1976 (hereinafter referred to as "Former Agreement"); and

WHEREAS, the Board of Directors of the Company by resolution dated June 20, 1980, removed Chase as trustee and appointed Irving Trust Company as successor Trustee; and

WHEREAS, the right to amend said Former Agreement is set forth in Article Twelfth thereof; and

WHEREAS, the parties thereto desire to amend and restate said Former Agreement;

NOW, THEREFORE, the Company and the Trustee do hereby declare and agree each with the other as follows:

SECTION 1. Establishment of Trust

The Company hereby establishes with the Trustee, pursuant to the Plan, a trust (hereinafter referred to as the "Trust") which shall comprise those assets delivered to the Trustee from Chase, together with such other sums of money and such property as shall from time to time be paid or delivered to the Trustee, and the earnings and profits thereto. All such money and property, all investments made therewith and proceeds thereof and all earnings and profits thereon, less the payments which at the time of reference shall have been made by the Trustee in accordance with this Agreement, are hereinafter referred to as the "Fund." The Fund shall be held by the Trustee in trust and dealt with in accordance with the provisions of this Agreement.

The Trustee hereby accepts the Trust created by this Agreement on the terms and conditions herein set forth.

SECTION 2. General Duties of the Trustee; Payments from the Fund

It shall be the duty of the Trustee (a) to hold the Fund, and to make purchases and sales of the assets comprising the same, as directed pursuant to Section 3 hereof and (b) subject to the provisions of Section 15 hereof, to make payments from the Fund including payment of administration expenses of the Plan to or on the written order of the Profit-Sharing Committee which is provided for in the Plan (hereinafter referred to as the "Committee"). The Committee is vested with authority to control and manage the operation and administration of the Plan.

It is expressly understood that the Trustee shall have no responsibility for the asset management or investment of the Investment Funds except as it may be directed pursuant to Section 3, and that the duties of the Trustee shall be only those expressly stated in this Agreement.

The Committee shall be solely responsible to insure that any payment directed under this Section or Section 15 hereof conforms to the provisions of the Plan, this Agreement, including Section 15 hereof, and the provisions of ERISA. The Trustee shall be subject to the directions of the Committee furnished to it in accordance with the provisions of this Agreement, and any such direction shall constitute the certification of the Committee that the direction is made in accordance with the terms of the Plan and this Agreement and is not contrary to the provisions of ERISA, and the Trustee shall be under no duty to make any inquiry with respect to the correctness of any such certification. The Trustee shall be under no duty to enforce payment of any contribution and shall not be responsible for the adequacy of the Fund to meet and discharge any liabilities under the Plan. If a dispute arises as to who is entitled to or should receive any benefit or payment, the Trustee may withhold or cause to be withheld such payment until the dispute has been resolved by the Committee.

In the event that any payment ordered by the Committee shall be mailed by the Trustee by registered mail directed to the person specified in such order at the latest address of such person filed with the Committee, and shall be returned to the Trustee because such person cannot be located at such address, the Trustee shall promptly notify the Committee of such return. Upon the expiration of sixty (60) days after such notification such order shall become void, and unless and until a further order of the Committee is received by the Trustee with respect to such payment, the Trustee shall thereafter continue to administer the Fund as if such order had not been made by the Committee. The Trustee shall not be obligated to search for or ascertain the whereabouts of any such person (or his duly appointed representative).

SECTION 3. Investment of the Fund

A. The Fund shall be invested and reinvested, without distinction between principal and income, as the Trustee may be directed by an investment manager (the "Investment Manager") who is duly appointed by the Committee, or by such other party as may under the terms of the Plan be the named fiduciary with respect to control or management of the assets thereof, and who qualifies as an investment manager under Section 3(38)(B) of the Employee Retirement Income Security Act of 1974 (hereinafter referred to as the "Act") in the following investment funds ("Investment Funds"):

Fund A. Funds designated by the Committee for investment in this Fund A shall be invested and reinvested in any fixed income property, real or personal, or part interest therein, wherever situate, including but without being limited to governmental, corporate or personal obligations, trust and participation certificates, leaseholds, fee titles, mortgages and other interests in realty, preferred stocks, certificates of deposit, evidences of indebtedness or preferred stock of foreign corporations or other enterprises, or indebtedness of foreign governments, and any other evidences of indebtedness or ownership on a fixed income basis (excluding specifically securities or other property of the Company), without being limited to the classes of property in which trustees are authorized to invest trust funds by any law or any rule of court of any State and without regard to the proportion any such property may bear to the entire amount of the Fund or any Investment Fund.

Fund B. Funds designated by the Committee for investment in this Fund B shall be invested and reinvested in common or capital stocks issued by corporations and in bonds, debentures or preferred stocks issued by corporations which may but need not be convertible into common stocks (excluding specifically any stock or other securities of the Company), call options and evidences of ownership in foreign corporations or other enterprises, without being limited to the classes of property in which trustees are authorized to invest trust funds by any law or any rule of court of any State and without regard to the proportion any such property may bear to the entire amount of the Fund or any Investment Fund.

The Committee may at any time or from time to time direct the Trustee to transfer funds from one Investment Fund to any other Investment Fund, but such transfers shall be made effective only on such dates as may be agreed upon by the Committee and the Trustee.

The Committee shall direct the Trustee in the allocation of contributions made under the Plan between the Investment Funds under this Section 3.

The Investment Manager may by written authorization delegate to the Trustee authority to invest all or any portion of any cash or cash balances in the Fund, in the Trustee's sole discretion in the Short Term Investment Fund established within the Collective Trust pursuant to this Section. In the absence of directions or authorization from the Investment Manager the Trustee shall have no power, duty or authority to invest the Fund except as expressly provided herein.

B. The Trustee shall from time to time establish, pursuant to the written direction of the Committee, an account (hereinafter referred to as the "Deferred Payment Account") for the purpose of holding assets of the Fund pending payments pursuant to Section 2 hereof. With respect to such account, the assets held therein shall be invested and reinvested by the Trustee in its sole discretion, in money market instruments consisting of marketable securities issued or guaranteed as to principal and interest by the Government of the United States or issued or guaranteed by agencies or instrumentalities thereof, domestic bank certificates of deposit, bankers' acceptances and bank repurchase agreements, high grade commercial paper and commercial paper master notes, high grade municipal bonds and notes, and Eurodollar investments.

Unless advised to the contrary by the Committee in writing, investments for this account will consist of obligations maturing within three years from the date of acquisition. Investments will be selected which correspond to short term cash flow requirements, to the extent that the Committee provides the Trustee with such specific requirements from time to time.

C. Notwithstanding any provision of the Plan or of this Agreement to the contrary, the Trustee may, as of any valuation date of the Collective Trust created by Irving Trust Company under a Declaration of Trust dated December 13, 1963 as thereafter amended (hereinafter referred to as the "Collective Trust"), in its discretion with respect to the Deferred Payment Account and if authorized or directed by the Investment Manager with respect to any Investment Fund, and with the approval of the Collective Trustee of the Collective Trust, transfer any part of the assets of such Fund to the Collective Trustee of the Collective Trust, for investment solely in the Short Term Investment Fund of the Collective Trust. To that end, the Trustee is hereby expressly authorized to permit the commingling of any or all of the assets of the Fund, through the medium of the Collective Trust, with the assets of other trusts eligible to participate in the Collective Trust under the terms thereof. During such time as any part or all of the assets of the Fund are held in the Collective Trust, they shall be subject to all of the provisions of the aforesaid Declaration of Trust as amended from time to time. The Trustee may withdraw upon the authorization of the Investment Manager all or any part of the interest of the Fund in the Collective Trust in accordance with the terms of the Collective Trust. To the extent of the interest of the Fund in the Collective Trust, the Collective Trust shall be part of the Plan.

D. The Trustee shall not be liable for interest on any cash balances it holds uninvested pending receipt of directions from the Investment Manager, in the absence of authorization from the latter to invest the same in the Trustee's sole discretion, nor liable for interest on any cash balances it may be authorized to invest in its sole discretion and may hold uninvested as it deems to be in the best interests of the Fund.

SECTION 4. Powers of Trustee

The Trustee is authorized and empowered:

(A) In its discretion with respect to the Deferred Payment Account, and at the direction of the Investment Manager with respect to any Investment Fund:

(1) to sell, exchange, convey, transfer or otherwise dispose of any property, at any time held by the Trustee, by private contract or at public auction, for cash or on credit, upon such conditions, at such prices and in such manner as the Investment Manager shall direct, and no person dealing with the

Trustee shall be bound to see to the application of the purchase money or to inquire into the validity, expediency or propriety of any such sale or other disposition;

(2) to sell or exercise any conversion privileges, subscription rights or other options and to make any payments incidental thereto;

(3) to consent to or otherwise participate in corporate reorganizations, mergers/ consolidations or other changes affecting corporate securities and to delegate discretionary powers and to pay any assessments or charges in connection therewith;

(4) to compromise, compound, settle or arbitrate any claim, debt or obligation due to or from it as Trustee and to reduce the rate of interest on, extend or otherwise modify, or to foreclose upon default or otherwise enforce any such obligation; to bid in property or foreclosure or to take a deed in lieu of foreclosure with or without paying consideration therefor and in connection therewith to release the obligation on the bond secured by the mortgage;

(5) to vote upon any stocks, bonds or other securities; and to give general or special proxies or powers of attorney with or without power of substitution, with all proxies and proxy materials relating to securities held in the Fund to be signed by the Trustee without indication of voting preference and forwarded to the Investment Manager for the making of all decisions

with respect thereto;

(6) for the purposes of the Trust, to borrow money from others, to issue the Trust's promissory note or notes therefor, and to secure the repayment thereof by pledging any property in its possession;

(7) to manage, administer, operate, lease for any period of years, regardless of any restrictions on leases made by fiduciaries, develop, improve, repair, alter, demolish, mortgage, pledge, grant options with respect to or otherwise deal with any real property or interest therein at any time held by it; and

(8) generally to exercise any of the powers of an owner with respect to stocks, bonds, securities or other property held in the Fund.

(B) In the administrative discretion of the Trustee with respect to the Deferred Payment Account and the Investment Funds:

(1) to make, execute, acknowledge and deliver any and all documents of transfer and conveyance and any and all other instruments that may be necessary or appropriate to carry out the powers herein granted;

(2) to hold property of the Fund in its own name or in the name of a nominee, including the nominee of any clearing corporation with which securities of the Fund may be deposited, and to hold any investment in bearer form, but the books and records of the Trustee shall at all times show that all such investments are part of the Fund; and

(3) to employ suitable agents, auditors and legal counsel or other advisers, and to pay their reasonable expenses and compensation.

SECTION 5. Administrative Expenses, Taxes and Trustee's Compensation

All brokerage costs and transfer taxes incurred in connection with the investment and reinvestment of the Fund, all expenses (other than fees for legal services rendered to the Trustee) incurred in connection with the acquisition or holding of any property hereunder and all income taxes or other taxes of any kind whatsoever which may be levied or assessed under existing or future laws upon or in respect of the Fund, shall be paid from the Fund, and, until paid, shall constitute a charge from said Fund. All other administrative expenses incurred by the Trustee in the performance of its duties, including fees for legal services rendered to the Trustee, such compensation to the Trustee as may be agreed upon from time to time between the Company and the Trustee and evidenced by a writing signed by an officer of the Company, and all other proper charges and disbursements of the Trustee shall be paid from the Fund, but if not so paid, by the Company, but until paid shall constitute a charge upon the Fund.

SECTION 6. Trustee's Liability; No Duty to Review

The Trustee shall not be liable for the making, retention or sale of any investment or reinvestment made or received by it at the direction of the Investment Manager, as herein provided, nor for any loss to or diminution of the Fund resulting from any action taken, or from any act omitted, by the Trustee at the direction of the Investment Manager as herein provided. The Trustee shall not be liable for any loss to or diminution of the Fund resulting from any action taken or omitted by the Trustee, other than at the direction of the Investment Manager, except if due to any failure of the Trustee to act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. The Trustee may from time to time consult with legal counsel, who may be counsel to the Company, and shall be fully protected in acting upon the advice of counsel.

The Trustee shall be under no duty or obligation to review any investment or reinvestment made or received at the direction of the Investment Manager nor to make any recommendation as to the disposition or continued retention thereof. Without limiting the generality of the foregoing, in the case of any transaction which is both directed by and executed by or through the Investment Manager, the Investment Manager shall have entire responsibility for assuring that the transaction does not violate the prohibitions of Sections 406 and 407 of the Act.

SECTION 7. Settlement of Trustee's Accounts

The Trustee shall keep accurate and detailed accounts of all investments, receipts, disbursements and other transactions hereunder, and all accounts, books and records relating thereto shall be open to inspection and audit at all reasonable times by any person designated by the Committee. Within ninety (90) days after the close of each fiscal year of the Trust (or such other date as may be agreed upon in writing between the Committee and the Trustee), and within one-hundred twenty (120) days after the effective date of the removal or resignation of the Trustee as provided in Section 8 hereof, the Trustee shall file with the Company a written account, setting forth all investments, receipts, disbursements and other transactions effected by it during the year ending on such date (but not including any part of such year for which such an account has previously been filed) and certified as to the accuracy of the information set forth therein. Such account may incorporate by reference any and all schedules and other statements setting forth investments, receipts, disbursements and other transactions effected during the period for which such account is rendered which the Trustee has furnished to the Company prior to the filing of such account. Each account so filed (and copies of any schedules and statements incorporated therein by reference as aforesaid) shall be open to inspection during business hours by the Committee and the Investment Manager, any person designated by the Committee or Investment Manager, and participants and beneficiaries for a period of ninety (90) days immediately following the date on which the account is filed with the Company. If, with good cause shown to the Committee, an account required of the Trustee hereunder shall not be filed within the applicable time specified above, such account shall be filed by the Trustee as promptly as possible after the expiration of such time, provided such account otherwise complies with the requirements of this Agreement, and such account so filed shall be open to inspection during business hours by the Committee and the Investment Manager, any person designated by the Committee or the Investment Manager, and participants and beneficiaries for a period of ninety (90) days immediately following the date on which the account is filed with the Company. Upon the expiration of such ninety-day period, the Trustee shall be forever released and discharged from all liability and accountability to anyone with respect to its acts, transactions, duties, obligations or responsibilities as shown in or reflected by such account, except with respect to any such acts or transactions as to which the Company, the Committee or the Investment Manager, participants or beneficiaries shall have filed written objections with the Trustee.

To the extent that the Trustee shall be required to value the assets of the Fund for any purpose, including any accounting as hereinabove provided, the Trustee may rely for all purposes of this Agreement upon any certified appraisal or other form of valuation submitted to it by the Investment Manager.

Nothing herein contained shall impair the right of the Trustee to a judicial settlement of any account of proceedings rendered by it. In any proceeding for such judicial settlement the only necessary parties shall be the Trustee, the Committee, the Investment Manager, the Company, participants and beneficiaries, and any judgment, decree or final order entered therein shall be conclusive on all persons having or claiming an interest in the Fund or under the Plan.

The Company shall have the sole authority to enforce this Agreement on behalf of any subsidiary or affiliate of the Company which has at any time adopted the Plan, and the Trustee shall in no event be required to deal with any such subsidiary or affiliate except by dealing with the Company as agent of such subsidiary or affiliate.

SECTION 8. Resignation and Removal of Trustee

The Trustee may resign at any time upon sixty (60) days' notice in writing to the Company and the Committee. The Trustee may be removed by the Company at any time upon sixty (60) days' notice in writing to the Trustee and the Committee. Within sixty (60) days after such notice of such resignation or removal of the Trustee the Company shall appoint a successor trustee. If within sixty (60) days after notice of resignation or removal of the Trustee shall have been given under the provisions of this section a successor to the Trustee shall not have been appointed, the resigning or removed Trustee or the Committee or any member of the Committee may apply to any court of competent jurisdiction for the appointment of such successor. Any successor trustee shall have the same powers and duties as those conferred upon the Trustee hereunder and subject to receipt by the Trustee of written acceptance of such appointment by the successor trustee, the Trustee shall assign, transfer and pay over to such successor trustee the funds and properties then constituting the Fund. The Trustee is authorized, however, to reserve such sum of money as it may deem advisable for payment of its fees and expenses in connection with the settlement of its account or otherwise and any balance of such reserve remaining after the payment of such fees and expenses shall be paid over to the successor trustee.

SECTION 9. Evidence of Company, Committee and Investment Manager Action, Committee Membership and Appointment of Investment Manager

Except as otherwise herein provided, any action by the Company pursuant to any of the provisions of this Agreement shall be evidenced by a resolution of its Board of Directors certified, under the corporate seal to the Trustee over the signature of the Secretary or of any Assistant Secretary of the Company, and the Trustee shall be fully protected in acting in accordance with such resolution so certified to it. The Company shall furnish the Trustee from time to time with certified copies of resolutions of its Board of Directors evidencing the appointment and termination of office of any members of the Committee, and of any other named fiduciary referred to in Section 3, and the appointment and termination of successors thereto. The Committee or such other named fiduciary shall file with the Trustee a copy of the instrument duly appointing the Investment Manager who shall file with the Trustee a copy of his written acceptance of his appointment and acknowledgment that he is a fiduciary with respect to the Plan and due evidence of his qualification under Section 3(38)(B) of the Act. All orders, requests and instructions of the Committee and the Investment Manager to the Trustee shall be in writing signed by two members of the Committee or two representatives of the Investment Manager, and the Trustee shall be fully protected in acting in accordance with such orders, requests, and instructions. The Trustee shall have the right to rely on and shall be fully protected in acting in accordance with any resolution, order, request or instruction which it believes to be genuine and which purports to have been signed in accordance within this Section.

SECTION 10. Termination of Plan

In the event that the Plan is terminated in whole or in part, with respect to all or any group of participants and their beneficiaries under the Plan, the Fund, or the portion thereof with respect to which the Plan is terminated, shall, subject to the provisions of Section 5 hereof, be held and/or disposed of by the Trustee in accordance with the written order of the Committee.

Anything hereinabove to the contrary notwithstanding, the Trustee may condition its delivery, transfer or distribution of any assets upon the Trustee's receiving assurances satisfactory to it that the approval of appropriate governmental or other authorities has been secured and that all notice and other procedures required by applicable law have been compiled with.

SECTION 11. Division of Fund

The Fund may be held by the Trustee in trust in common with assets of any other plan of the Company or its subsidiaries or affiliates as long as such other plan is qualified under Section 401(a) of the Internal Revenue Code of 1954, as amended. In such case, the Trustee shall be under no duty to earmark or keep separate the assets of the Fund but may commingle them with the assets of the other plans. The Trustee shall, however, upon the direction of the Committee, maintain a separate account reflecting the proportionate share of each plan in the Fund. For this purpose, the Trustee shall determine the value of the assets of each plan in the Fund as of the last day of each fiscal year and as of such other date as the Trustee may deem appropriate or the Committee may direct. Assets shall be valued at their market values at the close of business on the date of valuation, or, in the absence of readily ascertainable market values, at such values as the Trustee shall determine in accordance with methods consistently followed and uniformly applied.

The Committee may at any time direct the Trustee to segregate and set apart assets representing the proportionate share of any other plan commingled in the Fund (or the proportionate share of any participant or group of participants and their beneficiaries under the Plan or any other plan),to be held as a separate trust fund for the exclusive benefit of the participants of such other plan (or of such participant or group of participants and their beneficiaries under the Plan or any other plan), under a separat agreement of trust substantially identical with this Agreement. In such event, the selection of the particular assets so to be segregated shall be made by the Committee and the Trustee shall segregate such assets in accordance with the written order of the Committee.

Except as provided above, the Trustee shall hold, invest and administer the Fund as a single fund without identification of any part of the Fund with or allocation of any part of the Fund to the Company or to any subsidiary or affiliate of the Company or to any participant or group of participants and their beneficiaries under the Plan or under any other plan whose assets may be commingled in the Fund, and the Trustee shall be under no duty to account separately to the Company or to any subsidiary or affiliate of the Company for the amounts contributed by such party to the Fund or for the Trustee's investment and administration thereof.

SECTION 12. Transfer of Assets

Upon written direction by the Committee, the Trustee shall (i) transfer and deliver such part of the assets of the Fund as may be specified in such direction to any trustee or insurance carrier maintaining any other investment medium of the Plan or to any trustee or insurance carrier maintaining any investment medium of a plan, other than the Plan, which qualifies under Section 401(a) of the Internal Revenue Code of 1954 into which plan the Plan (or any portion thereof) shall be merged or consolidated, or (ii) accept the transfer to the Fund of assets acceptable to it from any trustee or insurance carrier maintaining any other investment medium of the Plan or from any trustee or insurance carrier maintaining any investment medium of a plan, other than the Plan, which qualifies under Section 401(a) of the Internal Revenue Code and which (or any portion of which) shall be merged or consolidated with the Plan. Any such transfer shall be subject to the provisions of Section 11 hereof and the Trustee shall have no liability or responsibility (i) to determine whether such transfer shall be in conformity with the provisions of any plan or of ERISA, or (ii) with regard to the effect of such transfer upon any shares of the Fund held in respect of participants or beneficiaries in the Plan whose interests (or any portion thereof) in the Fund are being so transferred to other funding media, whose interests in other funding media are being so transferred to the Trust Fund, or in respect of participants or beneficiaries in the Plan whose shares in the Fund are not directly subject to any such transfer. Any such direction of the Committee shall constitute a certification that the transfer so directed is one which the Committee is authorized to direct and which is in conformity with the provisions of the Plan or any other plan, this Agreement and ERISA.

The provisions of Section 10 shall be applicable with respect to any payments or transfers under this Section 12.

SECTION 13. Affiliated Organizations. Any company which is a subsidiary of the Company or which may be affiliated with the Company in any way and which is now or may hereafter be organized under the laws of the United States of America, or of any State or Territory thereof, may, with the approval of the Board of Directors of the Company, by resolution of its own Board of Directors, adopt the Trust if such subsidiary or affiliate shall have adopted the Plan. All references in this Agreement to employees of the Company shall be deemed to include the employees of each such subsidiary or affiliate which has adopted this Trust ("Affiliated Entity"). The contributions which may be made by each Affiliated Entity and the income therefrom, shall be held by the Trustee as a part of the Trust Fund in accordance with Section 11. Each Affiliated Entity appoints the board of directors of the Company as its agent to exercise on its behalf all of the powers and authority conferred upon the Company by this Agreement, including, without limitation, the power to amend this Agreement or to terminate this Trust; provided, however, that the Company shall not have the power to terminate this Trust solely with respect to the interest therein attributable to an Affiliated Entity without the consent of such Affiliated Entity. The Committee shall act with respect to the Plan as adopted by an Affiliated Entity in the same manner as it acts with respect to the Plan as maintained by the Company, and any Affiliated Entity shall take such action as may be necessary in order to designate the Committee as the named fiduciary of the Plan maintained by it. Evidence of such designation and appointment shall be in such form as shall be acceptable to the Trustee, but no such acceptance shall increase the responsibilities or duties of the Trustee under this Agreement, or otherwise.

SECTION 14. Amendment of Agreement

The Company reserves the right at any time and from time to time to modify, amend or terminate, in whole or in part, any or all of the provisions of this Agreement provided that no such modification or amendment which affects the rights, duties or responsibilities of the Trustee may be made without its consent in writing.

SECTION 15. Exclusive Benefit

Notwithstanding anything to the contrary contained in this Agreement, or in any amendment thereto, it shall be impossible, at any time prior to the satisfaction of all liabilities with respect to the members under the Plan or their beneficiaries, for any part of the Trust Fund, other than such part as is required to pay taxes and expenses of administration of the Plan and Trust to be used for, or diverted to, purposes other than for the exclusive benefit of the members under the Plan or their beneficiaries; provided, however, that in the event that the Committee shall certify that (i) any contribution has been made by the Company by a mistake of fact, or (ii) that a contribution to the Trust has been conditioned on qualification of the Plan under Section 401, 403(a) or 405(a) of the Internal Revenue Code of 1954 and that such qualification has been denied, or (iii) that a contribution has been conditioned upon the deductibility thereof under Section 404 of the Code and that such deduction has been disallowed, and shall direct the return of any such contribution, the Trustee shall return such contribution (or the value thereof if less) to the Company in accordance with such direction, but in no event shall any such return be made other than prior to the expiration of one year following the payment thereof in the case of a direction under (i) above, the denial of qualification in the case of a direction under (ii) above, or the disallowance of the deduction in the case of a direction under (iii) above.

SECTION 16. Alienation of Benefits

No distribution or payment under this Agreement to any participant or his beneficiary under the Plan shall be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance or charge, whether voluntary or involuntary, and no attempt so to anticipate, alienate, sell, transfer, assign, pledge, encumber or charge the same shall be valid or recognized by the Trustee, nor shall any such distribution or payment be in any way liable for or subject to the debts, contracts, liabilities, engagements or torts of any person entitled to such distribution or payment, except in the case of any voluntary and revocable assignment of not to exceed 10 percent of any benefit payment and except to such extent as may otherwise be required by law. If the Trustee is notified by the Committee that any such participant or beneficiary has been adjudicated bankrupt or has purported to anticipate, alienate, sell, transfer, assign, pledge, encumber or charge any such distribution or payment, voluntarily or involuntarily, the Trustee shall, if so directed by the Committee, hold or apply such distribution or payment or any part thereof to or for the benefit of such participant or beneficiary in such manner as the Committee shall direct.

SECTION 17. Governing Law

This Agreement shall be administered and construed according to the laws of the State of New York, except as may otherwise be required by Section 514 of the Act.

IN WITNESS WHEREOF, this instrument has been executed, as of the day and year first above written by Harper & Row Publishers, Inc. and its corporate seal affixed and attested, by its officers thereunto duly authorized, and by Irving Trust Company and its corporate seal affixed and attested, by its officers thereunto duly authorized.

HARPER & ROW, PUBLISHERS, INC.

(Corporate Seal)

Attest:

By ____________________
President

By Barbara
Secretary

IRVING TRUST COMPANY

(Corporate Seal)

By ____________________

Attest:

By ____________________
Assistant Secretary

STATE OF NEW YORK)
)ss.:
COUNTY OF NEW YORK)

On the 29th day of August 1980, before me personally came Brooks Thomas to me known, who being by me duly sworn, did depose and say that he resides at 37 West 12th Street, New York, New York 10012, that he is the President of Harper & Row, Publishers, Inc., the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation, and that he signed his name thereto by like order.

LINDA S. ROGERS
Notary Public, State of New York
No. 31-4486230
Qualified in New York County
Commission Expires March 30, 1982

STATE OF NEW YORK)
)ss.:
COUNTY OF NEW YORK)

On the 29 day of August 1980, before me personally came Ronald J. Obredick to me known, who being by me duly sworn, did depose and say that he resides at 938 MADISIN AVENUE PLAINFIELD, NEW-JERSEY 07060, that he is a VICE PRESIDENT of IRVING TRUST COMPANY, the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation, and that he signed his name thereto by like order.

DOROTHY M. TOMCEY
Notary Public, State of New York
No. 31-9352485
Qualified in New York County
Commission Expires March 30,

MANUFACTURERS HANOVER TRUST COMPANY

600 FIFTH AVENUE NEW YORK, N. Y 10020

December 3, 1981
Telephone Number
(212) 957-1811

RL 50803-02
RL 50805-05

Ms. Mary Pat Leon
Assistant Secretary
Irving Trust Company
1 Wall Street, 12th Floor
New York, New York 10015

Dear Ms. Leon:

Re: Harper & Row Publishers
Profit Sharing Plan

Enclosed is our acceptance effective December 1, 1981 of our appointment as Successor Trustee of the Trust for the Harper & Row, Publishers, Inc. Profit Sharing Plan.

Sincerely yours,

Helen Gluesing

(Mrs.) Helen Gluesing
Assistant Trust Officer

Enc.

NOTICE OF ACCEPTANCE

Manufacturers Hanover Trust Company hereby accepts, effective as of December 1, 1981, its appointment as successor trustee of the trust for the Harper & Row, Publishers, Inc. Profit Sharing Plan, established by Agreement dated as of October 10, 1969 between Harper & Row, Publishers, Inc. and Chase Manhattan Bank, N.A. as heretofore from time to time amended and now in effect.

MANUFACTURERS HANOVER TRUST COMPANY

By: ______________________
Vice President

ATTEST:

____
Assistant Trust Officer

December 3, 1981

Internal Memorandum

Date

November 10, 1981

From

R. W. Betz

To

Files

Subject

Harper & Row Profit-Sharing Trust

PERSONAL TRUST DIVISION
EMPLOYEE BENEFIT
TRUST FILES
ADMINISTRATION
DOCUMENTS ☒
CORRESPONDENCE ☐
PERMANENT
PAYMENT AUTHORIZATIONS ☐
CORRESPONDENCE ☐
DOCUMENTS ☐
INVESTMENT REVIEWS AND RECOMMENDATIONS ☐
REPORTS ☐
TEMPORARY ☐
APPROVED FOR FILING
ADM. R. W. BETZ

The purpose of this memorandum is to set forth the background and circumstances leading up to our resignation as Trustee under the Harper & Row, Publishers, Inc. Profit-Sharing Plan.

In early September, Norman Cannon, Treasurer, called to advise us that the Company will amend the Profit-Sharing Plan and the Trust Agreement to provide for up to 100% investment of plan assets in Harper & Row common stock. Norm wanted to know if we would continue to serve as Trustee under the amended Plan. In order to gather more details, Steve Wells and I met with Norm on Friday, September 4, 1981.

At the outset of the meeting, Norm mentioned that nothing will happen until the early November stockholders' meeting at which time the Company will submit the Plan amendments for approval. The desire to amend stems from the fact that the Minnesota Times Herald wants to sell its shares of Harper & Row stock (approximately one-third of the outstanding shares). Harper & Row has decided to purchase these shares at $20 per share which is in excess of the current market price. Further, Harper & Row wants to sell these shares to the Profit-Sharing Plan and the Pension Plan (trusteed by Morgan Bank) at market price. Any shares not sold to the plans will be used to create a trust for the exclusive benefit of employees. The Company will not make any contribution to the plans for at least the next five years. It is anticipated by the Company that the benefit to be derived from the new trust will outweigh the lack of contributions for the next five years.

He said that plan participants will be given the opportunity to withdraw their current balances, which the Company expects to result in a $2 million distribution. This would leave an estimated $2 million in trust to be used to purchase the shares of Company stock resulting in the Trust owning approximately 5% of the outstanding shares.

Currently, the Trust is composed of two funds managed by Wright Investors, a diversified equity fund and a fixed income fund. The amendment to the Plan would force the sale of securities held in both funds in order to raise cash to purchase the Harper & Row stock. Under the Plan as amended, investments will be limited to Harper & Row stock and short term investments. There would not be any discretion on the part of the Trustee to sell shares of stock nor would the Trustee have discretion to purchase additional shares of Company stock. Any dividends received would be invested in short term securities. The Trustee would have sole discretion with respect to voting control of the Harper & Row stock.

I asked Norm if the Company was going to seek IRS approval prior to restructuring these assets. He said that he was not sure (later on, he said that the attorney's were preparing the filing with the IRS). Throughout the conversation, due to a lack of knowledge or whatever, Norm was not very responsive to our questions. I told him that we would want to see the text of the Plan amendments before agreeing to continue as Trustee. Steve said that he would want to receive an opinion of their counsel covering these amendments. Norm did not object, in fact, he gave Steve the name and telephone number of their counsel, Mark Vogel of Weil, Gothshal & Manges. Steve said that he would call Mr. Vogel to discuss the amendments and voice our concern based on the O'Neill vs. Marriott Corporation case.[1] (Steve and Arthur Sporn feel that this case has a strong similarity to the Harper & Row proposed actions.) Norm promised to provide us with a copy of the Plan amendments, but to date, we have not received them.

After the meeting, Steve contacted Mr. Vogel and discussed our concern with the similarity between the Harper & Row action and the Marriott case. Mr. Vogel said that they are aware of the potential problems and understand our position and, further, if we do not want to be involved, they have available individual trustees.

On September 25, Gary Davenport, Roy Ortman, Steve Wells, Mary Pat Leon and Bob Betz met to discuss the facts of the situation and to reach a decision regarding our continuing as Trustee under the Plan. During the meeting, Gary called Arthur Sporn to seek his opinion. After careful analysis, it was decided that in light of the potential for a lawsuit, along the lines of the Marriott case, we are not in a position to assume the responsibility for continuing to act as Trustee.

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1. This action was brought by Velma O'Neill seeking monetary and injunctive relief against the defendents (Marriott Corporation, corporate officers and trustees or fiduciaries under the trust)

I contacted Norm Cannon on September 29 to advise him of our decision. I said that, if he wished, he could remove us as Trustee rather than our resigning. He asked for a few days to get back to me. He then called to say that it doesn't make any difference to Harper & Row and, accordingly, we issued a formal letter of resignation on October 2, 1981.

Since our decision to resign as Trustee, the media carried reports of the purchase of Grumman common stock for the Grumman Pension Plan by the individual trustees (all Grumman senior officers). The purchase was made in an attempt to prevent a takeover of Grumman by LTV. The Department of Labor called for the removal of the individual trustees on the ground that they violated provisions of ERISA which are designed to prevent the assets of a pension plan from being used to benefit the company. The violation took place when the trustees authorized the purchase of 1.16 million shares of Grumman stock at $36 per share (a record high) for the Pension Plan and then announced that they would not sell any shares to LTV. The DOL is asking that the three trustees reimburse the fund out of their pockets, for any losses to the fund resulting from the purchase. This situation certainly points out the sensitivity to holding Company stock in an employee benefit fund particularly when the fund was not designed to invest heavily in company stock.

RWB/jr

cc: T. W. Archibald
G. L. Davenport
R. T. Ortman
M. P. Leon

Securities Act and are based on the defendents alleged material misrepresentation regarding diversification in investment of trust assets, insulation against loss due to market decline and violations of fiduciary standards based on allegations of failure to discharge fiduciary obligations, self-dealing and negligence in failure to diversify investments.

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Mr. James H. Higby
Assistant Treasurer
Harper & Row Publishers, Inc.
10 East 53rd Street
New York, New York 10022

August 29, 1980

Re: Harper & Row Publishers Inc.
Profit Sharing Trust

Dear Hal:

Pursuant to Section 5 of the Trust Agreement, we are writing to outline the proposal of our compensation as trustee.

We propose to apply the following schedule to the directed funds under the Trust based on the aggregate market value of the assets held in the funds as of each April 30:

Schedule

1/4 of 1% on the 1st 1,000,000
1/8 of 1% on the next 4,000,000
1/16 of 1% on the next 5,000,000

$2.00 - non-recurring check
.60 - recurring check

With respect to the Deferred Payment Fund, we will apply a flat fee of $1,000 per annum.

Additionally, we will bill you directly for the cost incurred in the maintenance of participant records to the extent that we will be charged by the Computech Fund Services, Inc. for such service.

Please be advised that our first bill will be rendered 4/30/81 and will be prorated accordingly. The above mentioned fee will be guaranteed through April 1982.

Please indicate your agreement to the above compensation by signing below.

Very truly yours,

Mary Pat Purcell
Assistant Secretary

cc: A. Malcolm

Mr. Norman Cannon
Treasurer
Harper & Row, Publishers, Inc.
10 East 53rd Street
New York, New York 10022

October 2, 1981

Re: Harper & Row Publishers Inc. Profit-Sharing Trust

Dear Norm:

As I advised you by telephone on September 29, we have decided, in consideration of the facts as presented to us relating to the restructuring of the plan and trust, to resign as Trustee under the Profit-Sharing Plan. Our formal notice of resignation is enclosed. We regret taking this action, but we are sure that you understand our concern for potential litigation.

We look forward to your notifying us of the appointment of a successor Trustee as soon as possible. We would not object to a waiver of the 60 day notice provided for in Section 8 of the Agreement of Trust. It is our desire that the appointment of the successor Trustee be accomplished prior to the restructuring of the Trust assets.

Please be assured that we will do everything to ensure a smooth and efficient transfer of Trust responsibility to the successor Trustee.

Sincerely,

RWB:eb
Enclosure

BEST AVAILABLE COPY

Harper & Row, Publishers, Inc.
10 East 53rd Street
New York, New York 10022

October 2, 1981

Re: Harper & Row, Publishers, Inc. Profit Sharing Trust

Dear Sirs:

We hereby tender our resignation as Trustee under the Agreement of Trust made as of September 1, 1980 by and between Harper & Row, Publishers, Inc. and Irving Trust Company. Pursuant to Section 8 of such Agreement of Trust we await your notification of the appointment of the successor Trustee.

Very truly yours,

RWB:eb

BEST AVAILABLE COPY

AUG 30 1982

MEMORANDUM FOR: CHARLES L. SMITH
Regional Administrator, New York

FROM: CHARLES M. WILLIAMSON
Acting Assistant Administrator
for Enforcement, PWBP

SUBJECT: Harper and Row Publishers, Inc.
New York, New York
Case No. 30-10159(48)

We have reviewed the Report of Investigation in the above subject case and will transmit the report to the Solicitor's Office for legal argument with respect to a Department finding that violations have occurred.

In order to assist the Solicitor's Office in making the best legal argument for violations, we believe that the New York Region should conduct additional investigation. Specifically, we believe the additional investigation should be performed in at least the following areas:

1. Obtain evidence relating to the merger of Lipincott[illegible] Company with Harper and Row in the late 1970's, particu[illegible]ly the role of Prudential Insurance Company in "partiall[illegible] financing the merger.

2. Review all Board of Directors meeting minutes of Harper and Row and MST; Profit Sharing Plan and Retirement Pl[illegible] Committee meeting minutes; and Audit Committee meeting minutes for the period February 1981 through January 1982. If portions of the minutes are not made available to the investigator(s) voluntarily, as appears to be the case in exhibits 15, 16 and 17 and attachment 11, a subpe[illegible] should be requested.

3. Obtain evidence as to the reason(s) the Irving Trust Company tendered its resignation as trustee of the Profit Sharing Plan (see exhibit 16).

OFFICE SYMBOL	[illegible]	DATE
DFSI	[illegible]	8/25/82
~~DFSI~~	SMB	8/26/82
LC	cw	8/26/82

4. Obtain evidence on why the Retirement Plan purchased an annuity contract from Prudential Insurance Company. Were other insurance carriers contacted or was there a formal or informal bidding procedure? Who made the decision to select Prudential?

5. Obtain evidence relating to the agreement between Kidder, Peabody and Company and Harper and Row with respect to the limitations of Kidder's engagement.

6. Obtain evidence from the Plans accountant (Arthur Anderson and Company) and actuary (Towers, Perrin, Forster and Crosby) on the role they played, if any, in the amendment of the Profit Sharing Plan and termination of the Retirement Plan. Obtain an explanation from the actuary as to the reason Prudential's interest rate assumption is so much higher than the interest assumption calculated for the Retirement Plan prior to termination.

7. Conduct indepth interviews of at least three members of the Retirement and Profit Sharing Plan Committees; three members of the Harper and Row Board of Directors; and two members of the Audit Committee. In addition, the Chairman of the Board of Directors of the MST should be interviewed. Also, the Prudential officials who were involved in the annuity contract arrangement with Harper and Row should be interviewed.*

8. For the period August 1, 1981, to January 31, 1982, prepare a schedule which will compare the market value of the high grade securities held by the Profit Sharing Plan relative to the market value of Harper and Row Common Stock. The schedule is intended to assist this office and the Solicitor in determining whether the Profit Sharing Plan has suffered losses, in the event the Department asserts that violations have occurred.

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* Joint interviews of fiduciaries and, if possible, services providers of the Plans should be avoided. Moreover, the interview list provided should not be interpreted to exclude other persons which you believe should be interviewed.

Since the Solicitor's Office has already begun its review of the investigation, we would like the Region to place a very high priority on completing the additional investigation. In the event some of the information requested above cannot be obtained and transmitted to this office within the next 30 days, we would like to receive an interim report with respect to the information obtained.

If you have any questions,on this matter or need further guidance, please contact Mr. Leonard L. Garofolo of my staff.

cc: Enforcement✓
Chron
SOL Info

LMSA:PWBP:ENFORCEMENT:DFSI:LGAROFOLO:CAW
8-25-82 N4720 Ext. 38834

OPTIONAL FORM NO. 10
JULY 1973 EDITION
GSA FPMR (41 CFR) 101-11.6

UNITED STATES GOVERNMENT

Memorandum

TO : NYRO

DATE: August 13, 1982

FROM : George L. Nash, AA/NYAO

SUBJECT: Harper & Row Publishers, Inc.
Retirement and Profit Sharing Plans

Transmitted herewith is additional information with respect to Subject supplenting the Action ROI previously submitted to NYRO. Inv. S. Kusiel contacted Harper & Row Publishers, Inc. which provided the following attached items:

1) H & R Employee Stock Plan Document & IRS submission
2) H & R Employee Stock Plan Trust Agreement
3) H & R Pension Plan (terminated) Trust Agreement
4) Summary Plan Description Pension Plan
5) Summary Plan Description Profit Sharing Plan
6) Summary Annual Report Pension Plan
7) Summary Annual Report Profit Sharing Plan
8) Correspondence regarding contract with Prudential Insurance Company to cover termination benefits from the Pension Plan
9) Cover letter from Harper & Row describing above items 1 - 9
10) Letter from Harper & Row describing previously submitted items which are Exhibits 15, 16 & 17 in the Action ROI & Item 11 below
11) Minutes Audit Committee Meeting 12/8/81 previously submitted and noted in item 10 above
12) Complete Exhibit 18 Action ROI

As noted in the letter from Harper & Row (Item 9 above) the Prudential contract has not received final approval from the New York State Insurance Department and therefore is not included in the submission.

1p

Buy U.S. Savings Bonds Regularly on the Payroll Savings Plan

Page 2

Correspondence between H & R and Prudential is contained in item 8.

Kidder Peabody & Co. was also contacted and provided a copy of the study it prepared for H & R with respect to Harper's purchase of H & R stock from the Minneapolis Star Tribune Company. (Item 13 attached.) Portions of the study are based on confidential data supplied by H & R regarding projections of future performance of the company. The material was furnished to DOL on the express understanding that it will not be copied and that only summaries of it will appear in DOL's report (Item 14 attached). Therefore, this item may be reviewed but only summaries of it may be inserted in the ROI to avoid its disclosure under FOIA. The data are to be returned to H & R as reflected in its letter. Also, Report of Interview of C. EDWARD MIDGLEY and LAWRENCE WARD of Kidder Peabody is included describing Kidder's prior relationship with H & R and detailing the time frame of its work on the study (Item 15 attached).

The CHAIRMAN. While we are at it, since this is a really important question that Senator Metzenbaum has raised, what steps really is the Department of Labor taking to insure that these terminations do not jeopardize the integrity of the insurance system administered by the PBGC, so that they don't imperil the pension benefits of employees who literally belong to the terminated plans? Can you give us a little outline on that?

Senator METZENBAUM. How much have you got pending there in applications for approval with respect to pension plans where they get this money out and they need to come to you for approval?

Mr. LILLY. Let me try to answer both questions. It is difficult sometimes being a witness as a lawyer because I am sitting up here and I want to try to stop and object to the questions, and that type of thing, but I can't. Let me try to answer both questions if I can.

The Department has recognized the seriousness of this problem and has been focusing on it for a number of years, both with Mr. Clayton when he was here and now with the Secretary's appointment of a new administrator of the pension welfare benefit programs. I think we will make great strides not only in addressing the problem but coming up with possible solutions for discussion with people up here and with others.

Mr. Chairman, in response to your question, the Department has said up, the Secretary has established, a working group within the Department of Labor which I am cochairing with Mr. Monks, the new Administrator of the Pension and Welfare Benefit Program, which I think will be a significant—he will make a significant contribution not only to this particular problem, but to the whole of ERISA enforcement and the ERISA policy area, because of his background, his understanding of this entire matter.

We have been studying this, and we have a very long piece going forward to the Secretary with regard to this problem. We have indicated to him what we think, as part of our examination of the overall problem, we need to do—and what the other affected agencies, of which there is a large number, as you pointed out, Senator, need to do.

The PBGC, of course, is the cutting edge of this because that is where the applications for a sufficiency letter come into, the Pension Benefit Guarantee Corporation.

In addition to the PBGC, we have the IRS because of the tax policy considerations and their qualification of plans; we have the Treasury Department because of the fiscal impact of this on the revenue; and we have the Council of Economic Advisors of the President and the Department of Commerce because of the economic, enormous economic implications of these terminations.

As you all are well aware, better aware of it than I am, we have somewhere between 800 billion and 1 trillion dollars' worth of assets in the pension plans, the private pension plans, in these United States. We think that we have to approach this entire question very, very carefully because, as you all in your wisdom have established, we have a voluntary pension system in this country. There is no obligation on any of these companies to set up a defined benefit or a defined contribution pension plan. They can terminate that in a second, and there is nothing we can do about it. But we have to ensure—

The CHAIRMAN. Let me just make this suggestion to you: I am going to submit all the rest of my questions in writing and keep the record open until the 13th for any other Senator to submit his questions in writing. I realize that you cannot bind the Secretary of Labor with regard to the 9-month moratorium.

Senator METZENBAUM. The chairman is not indicating that Mr. Lilly is not coming back before——

The CHAIRMAN. No. That is what I was going to ask the distinguished Senator from Ohio. Is it possible you could submit your questions in writing——

Senator METZENBAUM. No.

The CHAIRMAN [continuing]. Or would you like to have more time?

Senator METZENBAUM. Yes.

The CHAIRMAN. The only time I have, Senator, would be this Friday at about 10 o'clock.

Senator METZENBAUM. Why don't we start at 8:30 again?

The CHAIRMAN. The problem is that I am going from 7:30 until probably 10 or 10:30. I will be happy to start at 10, but that is about the best I can do.

Mr. LILLY. Senator, if you are just trying to make my kids happy and get them out of school another day, I would be happy to come down on Saturday, if that would be easier. [Laughter.]

The CHAIRMAN. We could do it Saturday morning. I am free Saturday morning.

If I can accommodate you that way, Howard—I have a lot of questions I can have answered in writing which will satisfy me.

Mr. LILLY. As you point out, it is a very important question, and I would be happy to come back Friday morning.

Senator METZENBAUM. Let me ask you a basic question because this would affect my whole attitude, and I am frank to say it.

Would the Department support a 9-month moratorium in order that Congress as well as the agencies involved may take a look without more of these pension funds slipping out the door? You have a $275 million A&P application pending with you.

Mr. LILLY. Let me try to answer that in two respects: No. 1, with respect to your actual question, let me get to that secondly.

Let me first address the question of applications. The Department of Labor itself does not rule on these applications.

Senator METZENBAUM. I know that.

Mr. LILLY. It is the Pension Benefit Guarantee Corporation.

Senator METZENBAUM. I know.

Mr. LILLY. They are an independent corporation established by ERISA. The Secretary of Labor is, however, chairman of the board of that corporation, but they process these through the normal staff operation.

We are briefing the Secretary with regard to terminations, both in his role as the policy advisor to the President on the question of pensions as the Secretary of Labor and in his role as chairman of the board of the Pension Benefit Guarantee Corporation.

The CHAIRMAN. Don't you have a constitutional question, namely whether you have a right to declare frozen—what one are voluntary plans. There is a law that——

Mr. LILLY. With regard to Senator Metzenbaum's actual question, I have spent the past two years at the Department of Labor, and Tim Ryan spent the year before that, very directly and very strongly, I should say, telling our lawyers that we don't make policy at the Department of Labor; we just provide legal advice.

I will be happy to take that question back to the Department, but I cannot sit here today and say that the Department will or will not be able to support such a moratorium, but I will raise it immediately and see if we can get back to you on Friday, if we can develop it at that point and get it cleared by the administration.

Senator METZENBAUM. As a matter of fact, if you can, call me and maybe we can add it on as an amendment to a capital punishment bill or something. [Laughter.]

Mr. LILLY. It might be an appropriate vehicle in terms of the punishment of capital we would be engaging in at that point. [Laughter.]

The CHAIRMAN. Senator Metzenbaum is extremely creative around here. [Laughter.]

Senator METZENBAUM. Let me say that I am not suggesting the ultimate resolution, nor am I suggesting that pension plans not be terminated. I am suggesting, give us enough breathing space so that we can look at it in an orderly manner without worrying that while we turned our back $367 million went out to Occidental Petroleum. I do not know about Amax—did that one go out? Amax went out, and you have others that have gone out. I just want to say, "Wait. Halt. Let's slow down a little bit." Let the proper committees look at it and let us pick your brains as to what you think is the right solution. That is all I am after.

I do not want to indicate that I want a law to prohibit the pension plans from being terminated. I want a law to declare a moratorium for 9 months. We certainly have the legal right to do that, and, with your support, we would do that.

The CHAIRMAN. That may be what we will decide to do. I would like to know what your best advice is and what the Secretary's best advice is on it.

I think the points the Senator from Ohio has raised are important and valid points.

You still would like to come back Friday, then?

Senator METZENBAUM. If they will do that——

The CHAIRMAN. Then you feel you could submit your questions in writing?

Senator METZENBAUM. I feel that if they will give us their support and we can get that 9-month moratorium—part of my issue with Mr. Lilly is whether or not they are doing enough. I know what their rights are and what their rights are not.

The CHAIRMAN. You do not have any question about his competence or his background or his ability. You are worried more about the policy down there at the Labor Department.

Senator METZENBAUM. He is an excellent father and a very good lawyer, as I understand it. [Laughter.]

The CHAIRMAN. Let me say this: Why don't you go down and chat with Ray about this? I would be happy to chat with you as well.

Senator METZENBAUM. Why don't you call——

The CHAIRMAN. Give Senator Metzenbaum and me a call, and let's see what happens.

In the meantime, we will reschedule this hearing until Friday at 10 unless Senator Metzenbaum is satisfied. As I understand it, all other Senators will be happy to submit questions. We will begin here at 10 right here in this room.

I want to compliment your wife and your children for giving you to the Department of Labor, and the time and effort that you are putting in. We think you are doing a terrific job.

There is no question in my mind about your ability or your capacity in this particular position. I think you really have brought a great deal of fairness and balance to that position, which I think your predecessor had also brought.

I am really pleased with some of the things that you are doing and some of the efforts that have been made, and some of the accomplishments that have been made, much of which started under Mr. Ryan, whom I compliment greatly here as well.

Your children should be very proud of you, as should your wife as well.

We want to thank you for being here.

Senator METZENBAUM. One last question: What was that Carson group that you mentioned?

Mr. LILLY. Karsten, Thomas L. Karsten is the asset manager for the Southern Nevada Fund that was managing the assets for the fund, and they sued Mr. Shenker and the corporations as well.

Senator METZENBAUM. OK. I just did not get the name "Karsten."

The CHAIRMAN. Thank you, Senator Metzenbaum.

Thank you, Mr. Lilly.

Mr. LILLY. Thank you, Mr. Chairman.

The **Chairman**. Hopefully, we can resolve this, so that we do not have to have that hearing on Friday. However, otherwise, we will continue then.

[The prepared statement of Mr. Lilly follows:]

STATEMENT OF FRANCIS X. LILLY, NOMINEE FOR POSITION OF SOLICTIOR OF LABOR, BEFORE THE COMMITTEE ON LABOR AND HUMAN RESOURCES UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

I would first like to thank Senator Mathias for introducing me today and for his kind remarks. I know his busy schedule, and I greatly appreciate his taking the time to appear with me today.

I also want to thank you, Mr. Chairman, and the members of this Committee, for scheduling the hearing on my nomination so quickly after the beginning of this session.

Mr. Chairman, I am deeply honored by the confidence that President Reagan and Secretary Donovan have shown in me through their action in nominating me for the very difficult and challenging position of Solicitor of Labor. I also would like to take this opportunity to thank my wife, Kitty, and our four wonderful children. They have provided not only their total and my greatest support, but, perhaps even more importantly, their understanding during my past three years of government service, and the 14-hour days and 6- to 7-day weeks that have attended those years.

I believe that I can comment fairly on both aspects of the Solicitor's job that I mentioned earlier--the difficulties and challenges. I served as Deputy Solicitor from January 1982 through April 1983 under T. Timothy Ryan, Jr., and worked very closely with Mr. Ryan during that time. After he resigned as Solicitor in late April 1983, Secretary Donovan delegated all of the Solicitor's duties to me. Thus, for the past nine months I have carried out the responsibilities of that position. Last November, President Reagan nominated me for the Solicitor's position, renominating me on January 24, 1984, during the new session of Congress.

My experience at the Department of Labor over the past two years has been demanding, challenging and exciting. Under the leadership of Secretary Donovan, the Department of Labor has taken significant strides towards the realization of the President's goals of getting America back on its feet and proud again. I would like briefly to highlight some of the Department's accomplishments over the past few years:

1. Central States Case

Let me begin with a brief discussion of the litigation involving the Teamsters Central States Pension and Health and Welfare Funds.

(a) In September 1982, the Department obtained what has been described as a historic consent decree in the very complex litigation brought by the Secretary of Labor involving the Central States Pension Fund. The Fund has approximately $4.8 billion in assets and 500,000 participants and beneficiaries, making it the largest multi-employer pension plan in the United States. The terms of the consent decree provide for the appointment of an Independent Special Counsel to monitor, review, and report to the court on all of the Fund's activities, as well as for the appointment of a Named Fiduciary to set investment policy, appoint investment managers, and oversee all of the Fund's investment assets. Each of these functions has been assigned to an outstanding individual or institution. The court appointed former Attorney General of the United States and United States Senator from Ohio, William B. Saxbe, as Independent Special Counsel, and he has performed exceedingly well in this capacity. More recently, the court approved the appointment of Morgan Stanley, Inc. to serve as Named Fiduciary beginning January 20 of this year. The Secretary and the Fund, with the encouragement of the court and the Independent Special Counsel, have worked hard toward a "new day" for the Fund's participants and beneficiaries, and these developments constitute major steps in that direction.

(b) In May 1983, the Secretary announced a series of agreements, subject to court approvals, with the Teamsters' Pension and Health and Welfare Funds and their current trustees. When implemented, these agreements, which were designed to settle all outstanding claims against the current trustees while preserving the Secretary's claims against former trustees and third parties such as the Estate of Allen Dorfman and the companies he controlled, will provide for recovery of $6.5 million from the current trustees' for alleged Employee Retirement Income Security Act of 1974 (ERISA) violations. The settlement amount is larger than any single recovery that has ever been obtained under ERISA, and will serve as a signal to all plan fiduciaries that, as Secretary Donovan has stated, we are "vigorously protecting the hard-earned pension and health and welfare benefits of America's working men and women."

You noted at Tim Ryan's confirmation hearing, Mr. Chairman, that the Teamsters' Central States Pension Fund had been investigated for 20 years, and understandably you wondered when we might see some results. I am proud to say that the Department of Labor has now obtained very significant results in both the Pension Fund and the Health and Welfare Fund cases. Due to the dedication, effort, and competence of Secretary Donovan, Solicitor Ryan, the Fund's representatives and all of the others involved in these enormous cases, 500,000 men, women, and children are far better protected today than when President Reagan, Secretary Donovan, and Tim Ryan assumed their offices in 1981.

2. Culinary Workers' Case

Let me now turn to what we refer to as the Culinary Workers' case.

As you will recall, Mr. Chairman, the Secretary brought suit under ERISA in 1977 against the trustees of the Southern Nevada Culinary and Bartenders Pension Trust, as well as against Morris Shenker and a number of corporations he controlled that had improperly received or benefited from Pension Trust assets. The investment manager for the Pension Trust's real estate assets also filed separate claims.

These cases, as often occurs in complex litigation, moved slowly for a long period of time, prompting you, Mr. Chairman, to ask the Department to explain to you and this Committee the status of this case and a number of other ERISA matters in early 1982. With your assistance, as well as the tremendous efforts of a number of dedicated and very good attorneys and other professionals at the Department, we prepared the case for trial on an expedited basis. In January 1983, we reached a monetary settlement with the trustees that resulted in $3.7 million being restored to the Pension Trust. The settlement preserved our claims against the Shenker defendants.

Trial against the Shenker defendants began in Las Vegas, Nevada right after Memorial Day 1983. On November 30, after more than 100 days of trial, the jury returned verdicts on the investment manager's claims, assessing damages of almost $35 million against Mr. Shenker and two of the corporations he controlled. We anticipate that the Secretary's separate claims under ERISA will be decided shortly by the presiding judge, who, under ERISA, has this function, rather than the jury. Again, it is obvious that we have made great strides in this case.

3. Strengthening of ERISA Enforcement

Last month, Secretary Donovan announced the separation of the Office of Pension and Welfare Benefits Programs (PWBP) from the Labor-Management Services Administration, within the Department of Labor. By May of this year, the new PWBP will be an independent agency within the Department, and the head of that agency will report directly to the Secretary. The establishment of an independent PWBP will result in more efficient and more vigorous enforcement of ERISA.

In addition, Mr. Chairman, you had previously noted that, within the Solicitor's Office, we had built up a backlog of pending investigations referred to our office. You also noted the negative effect this backlog had on the expeditious processing of extremely important and very complex cases. I am pleased to report that we have eliminated that backlog, and we in the

Solicitor's Office are working very closely with Mr. Robert Monks, the new PWBP Administrator, to ensure coordinated, effective and expeditious enforcement of ERISA.

4. Davis-Bacon Reform.

I would now like to address our new Davis-Bacon regulations.

As you know, Mr. Chairman, in 1980, then-candidate Ronald Reagan pledged that he would not seek repeal of the Davis-Bacon Act but, rather, would see to it that administration of that Act was reformed to correct serious problems that had arisen under it. President Reagan has kept that pledge. The Administration, under the leadership of Secretary Donovan, has effected reform of the way that law is administered, and these efforts have received the approval of the federal judiciary.

In May 1982, the Department of Labor promulgated new regulations under the Davis-Bacon Act. These regulations were challenged and the district court enjoined the implementation of the regulations. On July 5, 1983, however, the Court of Appeals for the District of Columbia Circuit, in a unanimous decision, upheld the great majority of these regulatory changes. Indeed, the court held that some of the new regulations were more consistent with Congressional intent than were the prior longstanding regulations.

On January 16 of this year the Supreme Court denied a petition that it review the case, thus removing the last obstacle to effectuation of the Secretary's regulatory changes.

In the Report of "Reagan Administration Regulatory Achievements" issued on August 11, 1983 by the Presidential Task Force on Regulatory Relief, the Davis-Bacon regulations were cited as one of the Administration's major achievements, and the cost savings to taxpayers were estimated at $585 million annually.

5. Service Contract Act Reform

Let me now turn to Service Contract Act Reform.

On October 27, 1983, the Department promulgated revised regulations under the Service Contract Act. Again, despite a challenge to these regulations, a federal court has upheld these regulations in all respects. The federal district court in the District of Columbia found that the new regulations were "the product of reasoned consideration of available alternatives." The court not only found that the regulations were reasonable and consistent with the language and history of the Act, but, like the court of appeals in the Davis-Bacon Act litigation, also held that, in some respects, our regulations were more consistent with the intent of the statute than the previous regulations had been.

6. Relationship with the Office of Management and Budget (OMB)

I am pleased to report, Mr. Chairman, that the Solicitor's Office, designated by the Secretary as the regulatory reform contact office at the Department, enjoys an excellent working relationship with the Office of Information and Regulatory Affairs at OMB. As you know, that office, which is headed by Christopher DeMuth, reviews major regulations for compliance with Executive Order 12291 and reviews paperwork burdens imposed on the public for compliance with the Paperwork Reduction Act. In the past three years, the Department submitted 165 regulations to OMB for review under the President's Executive Order, and to date none has been rejected. I feel confident that Mr. DeMuth's office would agree that, even where our two offices have had differing views, we have been able to work out those differences in a professional and effective manner through the hard work of the Department of Labor staff, Mr. DeMuth, his deputy Bob Bedell, and the others involved.

7. The Homeworker Regulations

As part of Secretary Donovan's efforts to effect regulatory reform, the Department of Labor, in 1981, proposed regulations that lifted the ban on various kinds of "homework". Up until that time, pursuant to authority enjoyed under the Fair Labor Standards Act, the Department of Labor had prohibited employers from using "homeworkers" in seven industries. After receiving comments on the proposed new regulations, the Secretary in October 1981 issued final regulations which retained the ban on certain homework, but lifted the ban as to the knitted outerwear industry.

The new regulations, permitting homework in the knitted outerwear industry, were challenged by the International Ladies Garment Workers Union and others, and, in 1982, the District Court for the District of Columbia upheld the regulations.

In 1983, however, the U.S. Court of Appeals for the D.C. Circuit reversed the district court's ruling, and thus would reimpose the ban. On February 1, 1984, the court of appeals denied a petition for rehearing filed by the intervenors. The Secretary has directed me and the Employment Standards Administration to pursue all available steps to ensure that this ban on homework is not reimposed while complying with any mandate issued by the Court of Appeals.

Having highlighted some of the Department of Labor's significant accomplishments in the past three years, Mr. Chairman, I would like to state briefly why I feel I am qualified to meet the challenges presented by this position. I bring to the position itself two full years of experience at the Department of Labor and seven years of the practice of law in the private sector with two major law firms, where I specialized in complex litigation. As you know, Mr. Chairman, there is no lack of such litigation at the Department of Labor. The Department has responsibility for enforcing, administering or interpreting all or part of some 138 statutes passed by Congress. We currently have almost 600 lawyers and in excess of 50,000 cases in litigation. Tim Ryan, my predecessor, was able to take control of that workload, as reflected in some of the accomplishments noted above, and I have attempted to continue his efforts.

Moreover, Mr. Chairman, like many in this Administration and Secretary Donovan's Department of Labor, I think I bring to this job an understanding based on personal experience of the challenges and dreams facing the working men and women of America. While I worked in an office as a lawyer after graduating from law school in 1973, I have not always worn the proverbial "white collar". As one of ten children raised by my wonderful parents right here in Washington, D.C., I learned early that nothing was going to be handed to me and that I would have to work hard for what I wanted. Starting in my sophomore year of high school, I worked as a construction laborer every summer thereafter. I then spent a few summers as a mailman for the Postal Service, and earned a little more than I did as a hod carrier. During my college years, I was fortunate enough to get a "free ride", as they say, by playing football. All this meant was that I had to practice or work out seven days a week during the season and five days a week in the off-season to maintain not only my scholarship, but in some games, it seemed, my life.

I recount these experiences, Mr. Chairman, not to bore you but rather to serve as an indicator that I, like many of the President's appointees at the Department of Labor and elsewhere, understand the ambitions of the American working people. We have pursued the same goals ourselves, and, let me assure you that I, at least, will do all within my limited powers to see to it that the laws are enforced and policies pursued that will enable the American worker and workplace to flourish again as they have in the past.

In concluding, Mr. Chairman, I would like to thank you and the members of the Committee for giving me this opportunity to address you and express the pride I feel in this President's and this Secretary of Labor's accomplishments in the past three years. I would be pleased to try to answer any questions you might have.

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

PART I: ALL THE INFORMATION IN THIS PART WILL BE MADE PUBLIC

Name: Lilly (LAST) Francis (FIRST) Xavier (OTHER)

Position to which nominated: Solicitor of Labor Date of nomination: 1/24/84

Date of birth: 27 (DAY) 7 (MONTH) 46 (YEAR) Place of birth: Washington, D.C.

Marital status: Married Full name of spouse: Kathryn Mahoney Lilly

Name and ages of children:
Francis X. (12) Christopher Edward (1)
Kimberly Anne (9)
Timothy Joseph Edward (6)

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Holy Cross College	1964-66		
Duke University	1966-69	B.A.	1969
Catholic University	1970-73	J.D.	1973

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

Athletic Scholarship (Football) - Holy Cross College and Duke Univ.

American Jurisprudence Award (Highest Grade in Catholic Univ. School of Law's Securities Regulation Course)

Assoc. Editor - Catholic University Law Review

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations for the last five years and any other prior memberships or offices you consider relevant.

Organization	Office held (If any)	Dates
D.C. Bar Assoc.		1974-Present
American Bar Assoc.	Subcommittee Co-Chair	1974-Present
Phi Delta Theta Fraternity		1981-Present
North Carolina Alpha Chapter		1968-69
Congressional Country Club		1979-Present

Employment record: List below all positions held since college, including the title or description of job, name of employer, location of work, and dates of inclusive employment.

Deputy Solicitor, Department of Labor, Washington, D.C. (1/82-Present)

Executive Assistant to Chairman of U.S. Synthetic Fuels Corp., Washington, D.C. (8/81-1/82)

Jr. Partner; Bryan, Cave, McPheeters & McRoberts; Washington, D.C. (1/79-7/81)

Consultant, White House, Washington, D.C. (1/81-8/81)

Associate; Arent, Fox, Kintner, Plotkin & Kahn; Washington, D.C. (8/73-1/79)

Law Clerk; Wilmer, Cutler & Pickering; Washington, D.C. 9/71-4/73)

Securities Analyst, National Association of Securities Dealers, Washington, D.C. (3/70-8/71)

Government experience: List any advisory, consultative, honorary or other part-time service or positions with Federal, State, or local governments other than those listed above.

None

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

None

Political affiliations and activities: List all memberships and offices held in or financial contributions and services rendered to all political parties or election committees during the last five years.

Legal Advisor (volunteer) to Office of President-Elect (11/80-1/81)

Reagan-Bush Committee, Advance Office (volunteer and paid consultant) (8/80-11/80)

Deputy Director (volunteer) Advance Office, Bush for President Committee (9/79-5/80)

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

N/A

2. State whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

No definite plans

3. Has a commitment been made to you for employment after you leave Federal service?

No

4. Do you intend to serve the full term for which you have been appointed or until the next Presidential election, whichever is applicable?

Yes

Potential conflicts of interest:

1. Describe any financial arrangements, deferred compensation agreements or other continuing financial, business or professional dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

None

2. List any investments, obligations, liabilities, or other financial relationships which constitute potential conflicts of interest with the position to which you have been nominated.

None

3. Describe any business relationship, dealing or financial transaction which you have had during the last five years whether for yourself, on behalf of a client, or acting as an agent, that constitutes a potential conflict of interest with the position to which you have been nominated.

None

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any Federal legislation or of affecting the administration and execution of Federal law or policy.

During 1979 and 1980, I represented the National Association of
Selective Distributors, Inc. in their efforts to have the
Private Express Statutes amended

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

N/A

The **Chairman**. The committee will stand in recess.

[Whereupon, at 9:15 a.m., the committee recessed, to reconvene, at 9 a.m. on Wednesday, March 14, 1984.]

NOMINATION

WEDNESDAY, MARCH 14, 1984

U.S. Senate,
Committee on Labor and Human Resources,
Washington, DC.

The committee met, pursuant to recess, at 9:02 a.m., in room SD-430, Senator Orrin Hatch (chairman of the committee) presiding.

Present: Senators Hatch and Metzenbaum.

OPENING STATEMENT OF SENATOR HATCH

The Chairman. Why don't we get started? The committee will be in order.

This morning we are holding another hearing on the President's nomination of Frank Lilly to be Solicitor of Labor.

I want to thank you, Mr. Lilly, for your prompt response to the written questions that committee members have submitted to you, and I hope, by holding the hearing today, we will be able to resolve any lingering questions that may remain so that we can act on your nomination next week.

I appreciate your being willing to come back. I really don't have any questions. I understand Senator Metzenbaum will be here momentarily, and we will just turn the time over to him and let him ask any questions he cares to.

This hearing can only go until about 9:50, but I think we ought to be able to cover the questions that Senator Metzenbaum has within that period of time.

We are happy to have Senator Metzenbaum here, and we will just turn the time over to him. Howard, we only have until about 9:50. We could probably go right up to 10 o'clock. But I think you ought to be able to get through your questions by that time; at least I have high hopes that you will.

Senator Metzenbaum. We will try.

The Chairman. All right.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator Metzenbaum. Mr. Chairman, I want to thank you for giving me and other members of the committee a second opportunity to question Mr. Lilly.

The Solicitor of the Department of Labor is an important position, and we want to be certain that the nominee is fully qualified to carry out his responsibilities.

The Labor Department was established by Congress in 1913 for the purpose of fostering, promoting, and developing the welfare of wage earners in the United States.

As I indicated to Mr. Lilly during his previous appearance before the committee, I am less than satisfied with the present administration's commitment to the historic mission of the Labor Department, and I hope that you will be able to convince me and other members of this committee that you are in fact fully committed to vigorously protecting the rights of workers as provided for under existing law.

In addition, I hope to secure a commitment from you to so advise the Secretary of Labor in the event that you believe that existing law and regulations do not adequately protect those rights.

To be frank, Mr. Lilly, your prior appearance and your responses to my written questions fail to make your case. First you have failed to enforce the provisions of title IV of the Employment Retirement Income Security Act, known generally as ERISA, with respect to terminations of overfunded pension plans.

Second, you have assisted Labor Department officials in withholding documents which were the subject of an important congressional investigation.

Third, you have chosen to provide only vague responses to allegations that the Department has failed to enforce the Landrum-Griffin Act in an evenhanded manner and has systematically dismantled its employer and consultant reporting enforcement program.

And, fourth, Mr. Lilly, the recent rash of pension terminations suggests to me that the Department has not taken adequate steps to protect workers from insecurity in their retirement years.

I intend to pursue these issues this morning. These are important concerns, and I hope you will be able to satisfy me and other members of this committee that as Solicitor you will aggressively protect the best interests of this Nation's working people.

Mr. Lilly, the last time you were before this committee, I asked you to call and tell me what the Labor Department's position is on my proposal to place a temporary moratorium on the issuance of notices of sufficiency by the PBGC and determination letters by the IRS. You have since informed me that the Department strongly opposes the moratorium.

In fact, the Secretary has written a letter to Senator Dole which states:

> Recently, a number of employers have terminated their overfunded defined benefit plans, and in some cases this was done in order for the employer to obtain a reversion of plan excess assets. In some cases, these situations may cause hardships for employees who expected to continue working under the pension plan for their entire work career.

Then it goes on to say in the same letter:

> A moratorium is not a neutral act. To penalize employers will cause a crisis in confidence that will erode public support of a system that depends on mutual respect between government and business for its continued success. We believe more study on our part is necessary.

I believe this position by the Labor Department is an abdication of its responsibility. More study. That is what people say when they don't want anything to happen. That's what the President of the United States says every time he wants to duck an issue. He appoints a new commission.

But the fact is, there is a responsibility to properly protect the retirement security of hundreds of thousands of American workers.

Mr. Lilly, regardless of the Department's position, please tell the committee your personal opinion on the desirability of imposing a moratorium.

The CHAIRMAN. Can I make one observation? You know, your own bill is a 9-month moratorium for the purpose of studying this. I mean, you are criticizing the President because he doesn't have all the answers and admits it and wants to appoint commissions, and yet what you want to do is, in essence, study this for 9 months, if I understand your proposal.

Senator METZENBAUM. The chairman is usually 100 percent right, but in this instance he is 100 percent wrong.

The CHAIRMAN. All right.

Senator METZENBAUM. I am not at all proposing a study for 9 months.

The CHAIRMAN. You just want to stop the terminations.

Senator METZENBAUM. It [illegible] a 9-month moratorium for the purpose of giving the Congress an opportunity to deal with the issue and legislate if the Congress determines that it is necessary.

The CHAIRMAN. The Congress is going to have to study it to make a determination.

I went to a big conference last weekend where this precise issue was brought up, and there are a lot of positions on it.

Senator METZENBAUM. So far—I don't have the exact number—but something like $550 million has gone out the door, and it is my understanding there are pending cases that would let approximately $550 million more go out the door. The exact numbers may vary a little from what I have stated.

But what I am saying on the moratorium is, give the Finance Committee that originally had jurisdiction of this matter, give this committee, if you please, an opportunity to determine what the proper policy should be.

But instead of that, all we get from the Labor Department is that we are studying the matter. To me, that is an abdication of responsibility and, maybe worse than that, it is irresponsible.

The CHAIRMAN. Well, Howard, if you would just yield one more time——

Senator METZENBAUM. You asked me to be brief.

The CHAIRMAN. I will.

Senator METZENBAUM. And now you are giving me a debate, so——

The CHAIRMAN. No, I don't want to debate, but I just want to make this point.

Senator METZENBAUM. I may have to keep you here later or I may ask Mr. Lilly to come back if you impose upon my time, Mr. Chairman.

The CHAIRMAN. Let me just make this point. I will take 30 seconds or less. I believe that we must study this matter. I don't fail to share your concern about it. But my point is, I am not sure Mr. Lilly should be held up because you and I both agree that we ought to study this matter. I am interested in holding hearings on it and doing other things, and we can do that. But he doesn't control this.

But let's ask your questions, and you answer them.

Senator **METZENBAUM**. A very good idea. Go ahead, Mr. Lilly.

Mr. **LILLY**. Senator, at this point, I think I have forgotten what your question was, but if I remember——

Senator **METZENBAUM**. I will tell you. Tell the committee your personal opinion on the desirability of imposing a moratorium.

Mr. **LILLY**. The Secretary's letter, as I think you accurately paraphrased it, indicated that the Department's position is that the imposition of a moratorium would not in fact be a neutral act at all, but would be an act that would change the essential nature of the private, voluntary pension system we have in this country.

The number of participants and the number of defined benefit plans that have been affected by these terminations is absolutely minuscule when compared to the universe and when compared to the value of the assets that private employers have put into private pension plans in order to provide for the retirement security of the employees, the working people of America.

If the Government, through the Department of Labor, is going to support a radical change in the rules of this game midway into the game, when the private employers of this Nation are putting literally millions of dollars a day into these retirement plans, then the Secretary's concern—and, I must admit, my concern, from a personal point of view, although I am obviously not the policymaker on this subject at the Department of Labor—my personal view is that that could very well disrupt a very, very useful and well functioning system to a degree that might threaten the system over its long term.

I think that one has to approach this type of issue with extreme care. It requires an exacting amount of study in the Department and a number of other agencies. As I think the voluminous documents we have turned over to you have shown, not only the Department of Labor but a number of other executive branch agencies are looking into this very, very carefully. We understand that Senator Nickles has set a hearing on this for the 20th of March at which people from the Department of Labor will testify to explain the type of analysis that we have done, the data that we have assembled, provide that data to the committee, and to engage, if it is deemed appropriate, with the committee if it so desires in the type of analysis and study which you, I think, have indicated you believe is necessary.

But at this juncture, the Secretary has indicated that he does not believe that a moratorium would be useful, and my personal opinion is that I share the Secretary's view on that. I think it would be a real danger and send the exactly wrong signal to the kinds of people we are trying to send the right signal to, which is that the Government, the Congress, set up the ERISA system in order to provide long-term financial security for the greatest number of American workers possible.

I think that is even more important these days as we take a look at the Social Security system and some of the problems it is encountering. I think the last thing we want to do is to get in there and do something at this point in time that is going to do anything to the employers who have to make these contributions. We don't want to encourage them to either be more reticent about making the contributions or to decide not to set up a plan at all because the Government is changing the rules in the middle of the game.

Senator METZENBAUM. Well, talking about changing the rules in the middle of the game, I will come back to some further line of questioning as to whether you indeed did not participate in doing exactly that when the IRS was prepared to issue a ruling and you prevailed upon them to withhold the issuance of the regulations. Now, if that isn't changing the rules of the game, then I don't know what is, because you had no authority with the IRS except by reason of your stature in the Labor Department, and you were able to get them to pull back on an action that they were prepared to take.

I consider that changing the rules of the game, only in that instance it helped the employers and it helped AMAX, and it did not help the working people and the retired people of this country.

Now, if any division, agency, or personnel under the authority of the Department of Labor would indicate that they were going to disregard a statutory mandate, and this failure was brought to your attention, I assume that you would take appropriate action in order to see to it that that not occur. Is that correct?

Mr. LILLY. If I understand your question, Senator, if a particular statutory provision required the Department of Labor to take an action or to not take an action and it was brought to my attention that Labor Department employees were not complying with the law, obviously, we would look at that situation very carefully.

Senator METZENBAUM. What does it mean, "Look into that question very carefully"? That is double talk, Mr. Lilly. What would you do? If you knew they were going to violate a statutory mandate, what would you do?

Mr. LILLY. If we determined that they were in fact going to violate a statute?

Senator METZENBAUM. That is what my question says.

Mr. LILLY. If we determined that in fact they were planning on violating a statute, we would tell them they could not do that.

The CHAIRMAN. Could you answer the first part of Senator Metzenbaum's assertion that you somehow or other improperly acted with the IRS?

Senator METZENBAUM. He will have a chance to get to that.

The CHAIRMAN. You are going to get into that? All right, because I would like him to answer that question.

Senator METZENBAUM. We will get to it.

Now, I want to take you through the chronology of events that led the Secretary of Labor to conclude that the Department should oppose the imposition of a moratorium. But first I want to give you an opportunity to clarify two items.

First I asked you in writing to describe the statutory authority in current law that provides jurisdiction for the Department of Labor to protect employees and retirees when overfunded pension plans are terminated. You responded that the decision to terminate was not covered by the fiduciary provisions administered by the Labor Department.

You went on to say, "However, the Department has asserted and believes it has the authority to ensure that the fiduciaries carry out their responsibility with regard to the distribution of assets following the sponsor's decision to terminate."

Is that the sole resource of the Department of Labor?

Mr. LILLY. The sole resource?

Senator METZENBAUM. The sole role of the Department.

Mr. LILLY. In your opening statement, Senator, you made a statement that one of the things you wanted to look into was the Department's failure to carry out title IV of ERISA.

As I am sure you are aware, title IV of ERISA assigns the responsibility under that title to the PBGC, not to the Department of Labor. As I indicated in my written answer to you, the Department of Labor has no formal role in the termination process under the provisions of ERISA.

However, it has been our belief and our stated position throughout this process that if, in carrying out the distribution of plan assets after the termination of a plan, there is any indication or information that comes to our attention that violations have occurred, then we will take what action we think is necessary in order to correct such violations.

But it has been our position, and it has been upheld by two courts, that there is no fiduciary action with regard to a termination of a plan and the Department of Labor simply does not become involved under title I of ERISA.

Senator METZENBAUM. I asked you, second, whether the Department of Labor had played any role in the AMAX Corp. negotiations. You replied:

> The Department of Labor did not play any direct role in the AMAX negotiations. As Deputy Solicitor of Labor, I do not think it would be appropriate for me to comment on PBGC's notice of sufficiency. Department representatives were advised of the proposed agreement between the PBGC and AMAX and the generic problem of spinoff terminations was discussed among Department of Labor and PBGC, IRS, and Department of Treasury representatives on several occasions.

Do you stand by that answer?

Mr. LILLY. Yes, I do, Senator.

Senator METZENBAUM. Well, then, let's go through the chronology and see whether or not, indeed, you did reply as to what transpired and whether it doesn't contradict your statement.

Now, as I understand the chronology of events, the PBGC initiated concerns about spinoff terminations. The IRS then agreed with the PBGC that spinoffs are not permissible under current law. The PBGC decided it wanted to permit spinoffs anyway. You and the Department of Labor participated in the AMAX negotiations. The notice of sufficiency issued to AMAX violated the statute. Lilly tried to convince IRS to back off its position of opposing spinoffs. The Department's role in pension terminations is more than described by Lilly.

Now, I will go through some questions with you on that subject.

Mr. LILLY. Could I state at the outset that there are a number of statements that you have made that I don't think are correct.

Senator METZENBAUM. All right, that is fine.

Ed Jones, Executive Director of the PBGC, wrote Buck Chapoton, the Assistant Secretary of the Treasury for Tax Policy, that he did not believe spinoff terminations constitute a termination within the meaning of ERISA, and in that letter he asks Mr. Chapoton if IRS will support the PBGC interpretation. The October letter was carbon copied to you.

Now, first, would you describe to the committee what is meant by a spinoff termination?

Mr. **Lilly**. I think what Mr. Jones was talking about in that situation is when a company will take a pension plan and divide it essentially into two parts. The people who are retired, the retirees and certain other people will be put in one portion of the plan, and people that are still working, that is, actives, as they call them, will be put in another portion of the plan.

The company will then take, in some instances—it depends on the facts of every case, obviously—but generally the company will allocate enough assets to fund the active lives into the active plan. Then it will allocate what they would refer to as the surplus assets into the other portion of the plan, and terminate the portion of the plan covering the retired lives, those retirees and certain other people. It can then obtain from the termination of the spinoff portion the excess assets and get those back into the company.

Senator **Metzenbaum**. All right.

Now, on July 25, Mr. Jones writes to Mr. Chapoton:

> At our recent meeting on the above subject, I expressed PBGC's view that the IRS is incorrect in its position that two separate plans are created when there is a division of a plan into two parts.

He goes on to conclude the letter by saying:

> We cannot envision this result as one intended by Congress. We think the potential abuse of the insurance system in this case and many others is apparent. We would hope that from a policy viewpoint, you would be able to reach the same conclusion and help prevent the abuse.
>
> Our general counsel is of the strong opinion that our case is substantially weakened if IRS continues to maintain that the carve-out arrangement results in there being two separate plans.

Now, then, another letter is sent to the same effect on October 26, and another letter is sent on November 18, 1983. And in that letter, Mr. Jones says to Mr. Chapoton again:

> However, the commitments do not directly address our basic legal concern as to whether spinoffs of this kind should be recognized as qualified terminations under title IV, in light of the IRS conflicting regulation on spinoffs.

Now, in December—do you agree with all of that up to that point?

Mr. **Lilly**. That those letters were written?

Senator **Metzenbaum**. Sure.

Mr. **Lilly**. Yes, but I would not agree that those were policy positions of those agencies at that point. What was going on at that juncture, and has been going on for almost all of 1983 was consideration of these very issues by the agencies involved.

Mr. Jones had a view that was developing. The IRS had a view that was developing. Some of the people at the Department of Labor participated in those meetings and those discussions. I personally did not. But at that point in time, a number of people concerned with pension policy generally were discussing these issues.

The statements you have quoted are statements by various policy officials saying, "here's what I think the policy ought to be." But those were not policies adopted formally by those agencies or by the Department of Labor with regard to pension policy generally.

Senator METZENBAUM. Mr. Lilly, are you now telling me that when Mr. Edwin M. Jones, Executive Director, wrote to Mr. Chapoton on July 25, October 26, and November 18, all on Pension Benefit Guaranty Corporation stationery—I am not sure about the October 26 letter; that one doesn't show the letterhead—that he was not writing with respect to a policy position of the PBGC but he was just doing it on his own? Is that what you are suggesting?

Mr. LILLY. I think, Senator, if you will take a look at the November 18 letter from Mr. Jones to me, you will see that he was sending these matters to the Department of Labor for our further consideration because——

Senator METZENBAUM. I don't know if I have that letter.

Mr. LILLY. We sent that one to you. He was sending these matters to the Department of Labor because the Secretary of Labor is the Chairman of the Board of the PBGC. The PBGC is a congressionally created governmental corporation. The policy decisions of the PBGC are not made by Mr. Jones but rather by the Board of Directors, and that is how the Department of Labor got involved with respect to advice being presented to the Secretary.

So these are not policy statements of the PBGC. These are Mr. Jones' personal views, where he was bringing to the other governmental agencies involved his concerns, very valid concerns in terms of how these agencies were going to handle this particular problem that was coming up at this particular point in time because of the developments in the market, the significant increase in the economy, the factors of interest rates, contraction of some of the work forces of some of these major companies.

In this unique period, these problems were coming to the PBGC in increasing numbers, and Mr. Jones was rightly concerned and began to get the other agencies involved. That is what the letters from Mr. Jones to Mr. Chapoton were, in the development of the administration's policy of how they would address this issue.

Senator METZENBAUM. Well, you say that they were not policy letters.

Mr. LILLY. I am saying they were not the established policy of the PBGC. They were Mr. Jones' views.

Senator METZENBAUM. Now you are disavowing Mr. Jones' right to write these letters? He says in them, "We cannot envision this result." "We think the potential." "We would hope." Who is the "we"?

One place he said:

> I would appreciate very much hearing from you this week if at all possible. We are actively engaged in litigation in an insufficient plan case and a court deadline is near, is imminent. Thank you for your consideration.

Now, every one of these letters—the October 26 letter: "We now have four pending cases." "Our general counsel advises me that if it were not for the present position of IRS, there is a reasonable likelihood that the PBGC in a contested case would prevail in its position as above stated." "We have been withholding action in these cases pending your further advice." "We do not think it appropriate to continue in this posture much longer." And, "We urgently request your response to our July 25, 1983, letter."

And now you are saying to me that in all of that—and I could go on with the same kind of "we" approach in the November 18 letter. Now you are saying to me that Mr. Jones was merely acting on his own and that he had no right to be speaking for the Board.

He concludes his letter of November 18 saying:

> We do not want to proceed on a basis which constitutes a material difference on a policy matter between Federal agencies, but the time is running out. We urgently need to know the Treasury Department's position in this matter to make a coordinated and prudent decision, and we request that you advise us of same by November 28.

And then he says—and he knows the difference between we and I—and the last line of his letter is, "I am also in contact with DOL." And he sends a copy of that to you. And you say that he was just acting on his own and that the——

Mr. LILLY. No, Senator, I am not saying that Mr. Jones was in any way acting ultra vires, if you will, with regard to his official duties.

As the Executive Director, it is his obligation to take such actions as he thinks are appropriate with regard to bringing these matters to the attention of the appropriate policymakers in the administration on issues facing the PBGC. But if you will take a look at the November 18 letter from Mr. Jones to me, he attaches to that a proposed agenda for a board meeting that he hoped would take place with regard to the PBGC Board.

Senator METZENBAUM. Is that dated December 1? Is that the one?

Mr. LILLY. No; the letter is dated November 18 from Edwin Jones to me.

Senator METZENBAUM. All right.

Mr. LILLY. He has on the agenda, the draft agenda for the meeting of the Board of Directors, issues relating to proposed termination of part of a plan with respect to only retired and deferred vested participants. That is the spinoff situation.

No. 3 on the agenda is "issues relating to termination of sufficient plans when a similar successor new plan is created which in effect continued the terminated plan." That is the termination reestablishment issue.

In his memo, which we also provided to you, of December 9, 1983, to the Secretary of Labor, he makes a request on the last page of that, on page 5, that—the last line of it is, "Your advice on how the PBGC should proceed with AMAX next week would be appreciated."

These statements clearly indicate that Mr. Jones is bringing to the Board the issue of terminations and reversions, and that Mr. Jones is asking the Board's guidance on what the policy ought to be. So again, Mr. Jones is attempting to get input properly and perfectly appropriately from the other governmental agencies involved. He is trying to get as much information as he can, see what their preliminary positions are, such as the IRS, the Treasury Department and Department of Labor with regard to title I of ERISA. We would then come to the Board and say, "Here is all the information we have, members of the Board. I, as Executive Director, would like your decision on how the PBGC ought to handle these matters." And that is throughout the memos from Mr. Jones to the Board of Directors of the PBGC.

Senator **Metzenbaum**. But it is not in the letters to Mr. Chapoton. The letters to Mr. Chapoton indicate that there already is a policy. You are saying that on November 18 he writes to you and also, I gather, Mr. Donovan at some point, and indicates that he wants the matter put on the agenda of the Board. But he is indicating to Mr. Chapoton that the policy has already been made by PBGC.

Mr. **Lilly**. I don't think so, Senator. I think what he is indicating to Mr. Chapoton is, Here is what the PBGC staff's current thinking is. What is your current thinking at the Department of the Treasury, Mr. Chapoton? Here is what the IRS's current thinking is. Here is what DOL's current thinking is. We would like to know what yours is, and we have to keep this discussion going and we have to expedite it because we have important and difficult decisions facing us down the road.

So the PBGC at that point had not adopted a position with regard to terminations and spinoffs, other than addressing the problem of here is how we have been treating them since 1979; they are increasing in number at this particular point in time; and should we continue to treat them the same way? And there was disagreement within the executive branch——

Senator **Metzenbaum**. Mr. Lilly, you are too good a lawyer to be making the statements you are making. He says in the first letter, July 25, "At our recent meeting on the above subject, I expressed PBGC's view that the IRS is incorrect in its position that two separate plans are created when there is a division of a plan into two parts."

He is not saying that this is a discussion matter. He is saying our policy is there.

Mr. **Lilly**. No, he is saying—excuse me, Senator, but he is saying, My view at the PBGC is.

Senator **Metzenbaum**. No, he is not saying my view; he is saying PBGC's view.

Mr. **Lilly**. I think what he is talking about is that his view as Executive Director and the staff's view at the PBGC are different from the IRS view.

Senator **Metzenbaum**. He is saying what?

Mr. **Lilly**. That the staff's view at the PBGC is different from the IRS's view.

Senator **Metzenbaum**. Show me in the three letters where he indicates that it is the staff and not the Board.

Mr. **Lilly**. When he is talking about the PBGC. He has not had a Board meeting with the PBGC during this period of time.

Senator **Metzenbaum**. I am asking you, and you are telling me that he is expressing the staff's view, and I am saying to you, there are three letters that he wrote to Mr. Chapoton. Show me in one of them where he says this is the staff view and the Board has not yet made a policy.

Mr. **Lilly**. I would refer you to the December 9, 1983, memorandum from Mr. Jones——

Senator **Metzenbaum**. Oh, I am not talking about that. I am talking about the three letters to Mr. Chapoton—that is all I am talking about—July 25, October 26, and November 18. He sends three letters. You just sat there and said to me that that is the staff view that he is expressing. I am saying to you that it is true that later on he goes to the Board and asks them to take some position. I don't know what actions they have taken up until then and how much authority he had. But when he wrote to Mr. Chapoton, he made it clear that it was PBGC, not Mr. Jones alone and not the staff alone, and you are saying to me, that isn't what the letter is saying. Now, I am asking you to explain to me, how is that stated in the letter?

Mr. **Lilly**. Well, I think what you have to do, Senator, is take a look at his memorandum to the Chairman of the Board, in which he says——

Senator **Metzenbaum**. Mr. Lilly, how can you tell me to look at his memorandum to the Board? It is written 6 months, 5 months later.

Mr. **Lilly**. One month later.

Senator **Metzenbaum**. Five months after July 25.

Mr. **Lilly**. One month after November 18, when he said——

Senator **Metzenbaum**. Sure, but that is the third letter that he has written, all of which are to the same effect, and you are telling me I've got to look at a December 8 letter. That is just an absurdity that you are giving me.

Mr. **Lilly**. No, it is the actuality, Senator, of a staff person at a governmental corporation which has a board of directors, much like if one of your staff people called up and said to somebody, Senator Metzenbaum says you had better do such and such. He may have implied or apparent authority, but if the person who was called comes to you and says, wait a minute, Senator; your staff person called me up and said such and thus, and did you authorize that? And you say, no, I never authorized that. That person may have thought I was saying that, but I never authorized that; don't worry about it.

Senator **Metzenbaum**. If you find a staff member of mine that does what you just said, I'll fire, if I didn't authorize him to do it.

Mr. **Lilly**. I am sorry?

Senator **Metzenbaum**. I would fire a staffer who said exactly what you said, that if somebody comes to you and says you had better do something, or Senator Metzenbaum says the following will occur, and I didn't authorize that, I would fire the staffer. It is just that simple. I don't think you will ever find a staffer of mine who will get ahead of me and tell you what I am going to do without checking with me. So don't say it is just like a staffer of mine might do.

The **Chairman**. Well, maybe I am missing something, but just to answer this, what do all these things have to do with you, anyway?

Senator **Metzenbaum**. It has to do with the fact that he then gets—you can shake your head——

The **Chairman**. Well, no. I just want to know.

Senator **Metzenbaum**. But they have to do with the fact that he then participates in a meeting——

The **Chairman**. Well, it seems possible for every letter that is written by the Department of Labor. I mean, my gosh——

Senator METZENBAUM. I am merely laying the foundation for the fact that the PBGC had taken a position prior to Mr. Lilly's involvement.

Mr. LILLY. I would disagree with you, Senator. I don't think the PBGC has taken a position, because the Board of Directors has not acted.

The CHAIRMAN. They cannot take a position without the Board. They may assert various opinions, but they cannot take a position.

Mr. LILLY. That is correct, Mr. Chairman.

The CHAIRMAN. So I don't know how you can make that argument, Howard.

Senator METZENBAUM. All right, now let's go over to December 7. IRS responds to Mr. Jones after a meeting of the Commissioner of IRS, the Assistant and Deputy Assistant Secretaries of Tax Policy at Treasury, the Associate Chief Counsel for IRS, and the Assistant Commissioner for Pension Plans of IRS.

The letter states that IRS finds that spinoff terminations are not terminations within the meaning of the ERISA statute, agreeing with the PBGC position as stated in those letters that were sent, and they are there.

Now, maybe we ought to look and see what that letter says:

> Increasing attention has been focused in recent months on the issue of defined benefit plans terminating with surplus assets, where the surplus reverts to the employer. Under the code, an employer is allowed to receive surplus assets from a terminated plan upon the satisfaction of all liabilities, provided the excess is due to actuarial error.
>
> However, in some situations, there are serious questions regarding the techniques being used to extract assets from plans. Two of the questionable techniques may be called the termination-reestablishment technique and the spinoff-termination technique.
>
> Under the termination-reestablishment technique, an employer terminates an overfunded plan and recovers all excess assets. The employer then establishes a new defined benefit plan, perhaps identical to the terminated plan, for the affected participants.
>
> The spinoff-termination technique may be exemplified by the following example.

Then he goes on to spell it out.

> The principal effect of both techniques is that the employer is able to obtain plan assets that would not otherwise have been available while continuing a qualified defined benefit plan.
>
> The techniques described present the possibility for serious abuse. The Service has been concerned about these abuses and has been studying the situation and the issues involved.
>
> In a recent meeting of the IRS/Treasury Policy Committee attended by the commissioner, the assistant and deputy assistant secretary for tax policy of Treasury, the associate chief counsel of (Technical) for the IRS and me, a decision was reached on the Internal Revenue Service policy in this area and the courses of action that are to be taken in an attempt to prevent the abuse of recovery of excess assets.
>
> The first approach involves the application of the substance-over-form doctrine. Under this approach, it is recognized that although each step in the process of recovering excess assets is permissible when considered independently, the substance of the transaction is that assets have been removed from an ongoing plan in violation of the code.
>
> Thus, the substance of the transaction will be the primary determinant of the permissibility of the series of steps, not the validity of the formerly independent steps.
>
> This approach may, in appropriate circumstances, also be applied to situations involving underfunded plans and the spinoff-termination technique in which the accrued benefits of participants are reduced.
>
> The second approach to be used is called the actuarial error theory. This approach would"—and I won't read that.

> Proposed regulations will be developed and issued as soon as possible which will present much more detail concerning the two approaches. However, the two approaches will be implemented immediately.

I didn't read that other paragraph because I didn't think it was relevant.

Now, Jones at that point memos Donovan on the AMAX case, which is a spinoff termination. He asks for guidance on how to proceed, and he sends a carbon copy to you. You are familiar with that?

Mr. Lilly. What is the date of that memo?

Senator Metzenbaum. December 9. That is that over there [pointing to blowup displayed on easel].

Mr. Lilly. I think that is the one I was just quoting from, Senator. Yes, I am familiar with that.

Senator Metzenbaum. It says:

> On December 8, the ERISA Policy Board met and discussed the following matters: The IRS letter of December 7 from Assistant Commissioner Winborne to Mr. Jones. With respect to one, the IRS/Treasury Department has now adopted a position that the termination of an overfunded defined benefit plan, accompanied by the reestablishment of the substantially similar defined benefit plan does not amount to a plan termination.
>
> Therefore, any recovery of assets would be a violation of the code, because the assets would be removed from an ongoing plan and would disqualify the plan. This approach is called by the IRS the substance-over-form approach.
>
> The PBGC's viewpoint has been that there is very little, if any, legal basis for concluding, but for the IRS's prior position on this matter, that a plan termination recognizable under title IV has occurred under either the spinoff termination arrangement or the straight plan termination-reestablishment technique.
>
> However, from a practical point of view, it can be contended that it is better to allow leeway for employers in this area to recover excess assets which are arising in so many cases under existing circumstances because of the high interest rates which insurance companies are assuming in pricing buy-out contracts, and to allow them to reestablish another defined benefit plan, because the PBGC may lose less premium revenue than if large numbers of defined benefit plans were to be terminated and changed into defined contribution plans, which appears to be permissible under ERISA section 4041(f).

Now, you are familiar with that, of course.

Mr. Lilly. Yes, Senator, I am.

Senator Metzenbaum. Do you feel that that is the main concern of the PBGC, about losing premium revenue instead of compliance with the statute?

Mr. Lilly. No, I don't, Senator.

Senator Metzenbaum. What action did you take regarding the PBGC's position that it had no authority but it was going to act, anyway?

Mr. Lilly. I am sorry, I missed your question. What do you mean, Senator? The position that it had no authority with regard to what?

Senator Metzenbaum. The PBGC indicated thereafter, even though it had been advised that it was illegal, that it was going to work around that and going to make it possible to go forward with the terminations, with the plans that had been submitted.

Now, my question to you is, what was your involvement in the PBGC arriving at that decision?

Mr. Lilly. Well, I don't think I understand your question exactly, but let me try to explain what involvement I did have with regard to this discussion, as I think we talked about at the last hearing. When it came to the attention of the Department of Labor through the numerous memos and communications that Mr. Jones had with us, that this issue had arisen, then my suggestion from the outset was that the Government proceed in a fashion—that is, the Department of Labor, the PBGC as a separate entity, the Department of Treasury, and the IRS—proceed in a fashion so that no single agency's actions, from its narrow perspective, would do anything to upset overall pension policy, which was currently providing enormous retirement benefits for millions of American workers.

My basic point from the outset was, we have to do this in a coordinated fashion, and what PBGC might think is very important and absolutely necessary to do, or the IRS might think is absolutely necessary to do or arrive at from the point of view of a preliminary policy decision, is not necessarily what ought to guide the Government in terms of its actions with regard to pension plan terminations.

Senator METZENBAUM. Well, didn't the PBGC at that point, or at all points, have an obligation to enforce the statute?

Mr. LILLY. Absolutely.

Senator METZENBAUM. The title IV language? Wasn't there an obligation to do that?

Mr. LILLY. There is, and there was.

Senator METZENBAUM. Well, did the Board of Directors of PBGC convene to discuss this matter?

Mr. LILLY. They have not.

Senator METZENBAUM. They never met to discuss this matter at all?

Mr. LILLY. They have not yet met to discuss this matter.

Senator METZENBAUM. Did you discuss this issue with lawyers or officials of AMAX or any other company seeking to use this method to terminate a plan?

Mr. LILLY. I have not.

Senator METZENBAUM. At no point have you discussed, directly or indirectly, with any lawyers or representatives of AMAX?

Mr. LILLY. I have never met with a representative of AMAX to discuss the termination.

Senator METZENBAUM. Did you meet with anybody from Celanese?

Mr. LILLY. We went to a briefing at OMB by the Celanese officials who were coming in to talk about the effects of terminations generally and the Government's approach that they ought to take, not with regard to the termination of Celanese's pension plan.

Senator METZENBAUM. Repeat that again for me. You met with them for what purpose at OMB?

Mr. LILLY. We went to a meeting at OMB that was requested by officials of the Celanese Corp. to state their views to Government officials. This was a pension working group in the administration which was asked if it could assemble to have the Celanese Corp. representatives state their views on what the Government's policy ought to be with regard to pension plan terminations. That was not a discussion of any particular pension plan terminations.

We have provided to you, Senator, the briefing paper that the officials from Celanese at that meeting provided to us.

Senator METZENBAUM. Did you meet with any representatives of the Johns-Manville Corp.?

Mr. LILLY. I have discussed the issue of plan terminations with a lawyer who I believe represents Manville on a number of occasions, but my understanding is that they are not in the process of terminating any pension plans.

Senator METZENBAUM. Have you discussed the matter of plan terminations with Lynn Coleman, AMAX lawyer?

Mr. LILLY. With whom?

Senator METZENBAUM. Lynn Coleman.

Mr. LILLY. No, Senator, I have never met Lynn Coleman in my life.

Senator METZENBAUM. Excuse me. It is Secretary Coleman. I am sorry.

Mr. LILLY. The former Secretary of Transportation?

Senator METZENBAUM. Yes.

Mr. LILLY. No, I have not.

Senator METZENBAUM. Excuse me. As a matter of fact——

Mr. LILLY. Bill Coleman.

Senator METZENBAUM. Bill Coleman. I consider it inappropriate that I asked you the question because Mr. Coleman told me that he had not been involved, and I respect his integrity, and so I don't mean to imply by my asking you the question that I am questioning his integrity. But I had forgotten that for the moment.

Now, then, did you and Lilly meet with Assistant Secretary Chapoton in Mr. Chapoton's office in which the language for the AMAX settlement was discussed?

Mr. LILLY. You asked me, Senator, whether or not I and Lilly had met.

Senator METZENBAUM. No, whether you and Jones had met. Excuse me.

Mr. LILLY. We went to a meeting at Mr. Chapoton's office that was attended by representatives from the DOL—myself and two other people—by representatives from the Department of Treasury, from the PBGC, and the IRS, to talk about plan terminations.

One of the issues that came up in the discussion of plan terminations generally was PBGC being concerned about how could they proceed with the AMAX case in light of the nonresolution of the policy issue regarding plan terminations. At that meeting, PBGC's staff people, including Mr. Jones, said, we have to have some kind of language that lets us get around this thing, to deal with this thing, if we don't have a policy on it. There was discussion of the language at that point in time, but from the point of view, not of the AMAX case per se, but from the point of view of pension policy, generally.

I think if you will take a look at the AMAX agreement, which I think you have been provided also, there is a provision in there that says something to the effect that "nothing in this agreement will be deemed to constitute a determination that a termination has occurred under ERISA." That provision was put in there as a result of the discussions that took place at that meeting.

Senator METZENBAUM. So that you did participate in working out an arrangement with the IRS making it possible for the AMAX termination to go forward?

Mr. LILLY. No; I don't think that is correct, Senator, because the determination of whether or not they would issue a notice of sufficiency or enter into a settlement with AMAX was solely within the province of the PBGC. The discussion that was taking place with the officials of Treasury, IRS, DOL, and PBGC was what effect, if any, will the issuance or nonissuance have on this overall policy issue. And if we are going to make a settlement, PBGC said, with AMAX, how do we do it without indicating, sending signals of one sort or another, to the pension community in general that we are going to allow or disallow this kind of action? That was the discussion in which we were involved.

Senator METZENBAUM. Well, as a matter of fact, hasn't the AMAX resolution, the manner in which that was handled, hasn't that now been considered to be a precedent for a number of other pension termination plans?

Mr. LILLY. Senator, you would have to ask the PBGC that. I am not intimately involved with that on a day-to-day basis, and I don't know what their approach is at this point.

Senator METZENBAUM. After that meeting, Mr. Jones wrote to you on December 20, 1983:

> This letter will serve to confirm the telephone conversation David M. Walker, my deputy executive director for insurance operations and system management, had with Mr. Winborne and you regarding the AMAX settlement which followed our meeting in Buck Chapoton's office on December 14, 1983.

Now, I thought you indicated a minute ago in your testimony that it was not a meeting regarding the AMAX settlement but general policy. Which is correct? You or the letter?

Mr. LILLY. What I said was correct, Senator. If you will look at the second paragraph of that letter, it says:

> As Mr. Walker reported, the agreement with AMAX incorporates the language we agreed to in our December 14 meeting, to the effect that, quote, "The agreement shall not be deemed to be a determination as to whether or not there exists a plan termination under ERISA."

That was the discussion that took place at the meeting with regard to AMAX, and that was the discussion that took place with regard to Mr. Jones' telephone call to me following that meeting saying, from the Department of Labor's perspective, does this language satisfy the Department of Labor vis-a-vis the general pension policy issues?

Senator METZENBAUM. But you had indicated that the meeting in the office with Mr. Chapoton was a general discussion and not with reference to the AMAX settlement.

Mr. LILLY. No, I don't think so, Senator. I think what I said was that it was on the policy issue, but that what was driving that policy issue was PBGC's great concern with the AMAX case which was staring it in the face at that particular point in time.

At that meeting, however, neither the IRS nor the Department of Treasury nor the Department of Labor attempted to tell the PBGC what it ought to do with the AMAX case. Our concern, the Department of Labor's concern—I cannot speak for the other agencies—was pension policy generally, not the AMAX case, and we did not attempt to influence PBGC with regard to what they ought to do with the AMAX case.

Senator **Metzenbaum**. But the AMAX matter was discussed at Chapoton's office?

Mr. **Lilly**. In the context of pension policy with regard to termination and reversion, not with regard to what PBGC ought to do or ought not to do.

Senator **Metzenbaum**. And specific settlement provisions were discussed.

Mr. **Lilly**. To my recollection, the only settlement provisions that were discussed were the general issue of whether we can recognize, can the PBGC allow this—issue a notice of sufficiency to AMAX and not bind the IRS because of the provisions in the regulations under section 4044 of ERISA and the analogous provisions under the Internal Revenue Code. The IRS expressed a concern that as soon as—and this is one of the major policy problems in this entire area—as soon as PBGC issues a notice of sufficiency, the IRS is bound, and that is one of the very complicated, thorny issues that we have been wrestling with for months in this particular area.

The discussion was, how do we get around the situation that if PBGC settles this case with AMAX, AMAX does not then have the hammer to bang IRS over the head and say that the issue of whether or not there is a valid termination here has been taken out of your hands, IRS, by the determination by the PBGC. That is the discussion that was taking place, not the particular provisions of any settlement agreement with AMAX.

Senator **Metzenbaum**. Well, Mr. Lilly, at one point in this proceeding, you indicated you had no involvement in the AMAX decision.

Mr. **Lilly**. No, I don't think so, Senator. If you will take a look at my answer, what I said was, we played no direct role in the negotiation of the AMAX settlement, and I think that is accurate. We did not play a direct role in the negotiation of the AMAX settlement.

Senator **Metzenbaum**. Isn't that sort of a play on words? You didn't play a direct role, but you were there when it was worked out.

Mr. **Lilly**. We never were in a meeting, Senator, with the people from AMAX and PBGC in which they were working out the settlement with AMAX. All we participated in was the governmental agency discussion of a policy in this area, not the settlement of this case.

Senator **Metzenbaum**. You say, "I played no direct role."

Mr. **Lilly**. Right.

Senator **Metzenbaum**. But the fact is, you are at a meeting. I am not talking about whether AMAX was there. You said, "The Department of Labor did not play any direct role in the AMAX negotiations." But the fact is that you were over in Mr. Chapoton's office with Mr. Jones, and it was at that point that the AMAX matter was resolved. So you did play a direct role in it, didn't you?

Mr. **Lilly**. I don't think so, Senator. What I would refer to as a direct role in the AMAX negotiations would be the Department of Labor officials or I sitting down with the people from PBGC and AMAX and saying, Here's the basis on which we will settle your case; not a discussion between all governmental officials talking about what ought the policy to be with regard to spinoff terminations.

Senator METZENBAUM. I am afraid, Mr. Lilly, that your answer does not make that clear, because you say, I played no role in the—I don't have the language.

Mr. LILLY. No; the language itself, Senator, says that the Department of Labor did not play any direct role in the AMAX negotiations.

Senator METZENBAUM. OK, and the fact is, you were in the AMAX negotiations—it doesn't say with AMAX. We are talking about the AMAX negotiations——

Mr. LILLY. I don't think you can——

Senator METZENBAUM [continuing]. Being held at the IRS.

Mr. LILLY. I don't think the AMAX negotiations were held at the IRS. I think the AMAX negotiations were held between AMAX and the PBGC.

Senator METZENBAUM. Well, but the fact is, it was that meeting that resolved the AMAX matter, wasn't it?

Mr. LILLY. I do not believe it was, Senator. I believe that after that meeting the folk from the PBGC went back to the PBGC and sat down and hammered out an agreement with AMAX, and that is what resolved the AMAX case, not any meeting at the IRS or the Treasury.

Senator METZENBAUM. Again, I will read you the letter from Mr. Jones:

> This letter will serve to confirm the telephone conversation David M. Walker had with Mr. Winborne and you regarding the AMAX settlement which followed our meeting in Buck Chapoton's office on December 14, 1983.

And then it goes on to say:

> As Mr. Walker reported, the agreement with AMAX incorporates the language we agreed on in our December 14 meeting, to the effect that the agreement shall not be deemed to be a determination as to whether or not there exists a plan termination under ERISA.

Now, Mr. Lilly, either you understand the English language differently than I do, or something, because Mr. Jones is saying it was the AMAX negotiations, the AMAX settlement; you were there; and you come here and say that DOL played no role at all in it, and it wasn't really the DOL; it was you who were there. You were the participant.

Mr. LILLY. Actually, there were three people from DOL there, Senator. But I would stand by what I said before, which is that we were not negotiating with AMAX.

Senator METZENBAUM. All right.

Mr. LILLY. We were discussing the issue with the other governmental officials, and the PBGC was doing all of the negotiation with AMAX.

Senator METZENBAUM. Mr. Lilly, can the PBGC, under current law, issue a notice of sufficiency if there was no termination within the meaning of title IV?

Mr. LILLY. I think that would be a question better addressed to the PBGC, but let me comment to the extent of my knowledge under section 4044, and that is that if there is no termination under law, then they would not issue a notice of sufficiency.

Senator METZENBAUM. Say that again, please.

Mr. LILLY. What I first said was, I think that would be a question better addressed to the PBGC legal staff as opposed to me, but my understanding of title IV as administered by the PBGC is that they will not issue a notice of sufficiency if there is not a termination of a plan, and that is the burning legal issue facing the PBGC and a number of other people at this point.

Senator METZENBAUM. But they just did it.

Now, let me ask you this question. On page 5 of the settlement agreement—I think it is called a settlement agreement—there is a paragraph 5 which reads, "This agreement shall not be deemed to be a determination as to whether or not there exists a plan termination under ERISA."

Is paragraph 5 on page 5, that paragraph, a common settlement provision?

Mr. LILLY. In PBGC settlements?

Senator METZENBAUM. Yes.

Mr. LILLY. I would have no idea, Senator.

Senator METZENBAUM. Well, didn't you just answer that you couldn't have a notice of sufficiency if there was no termination within the meaning of title IV?

Mr. LILLY. I said my opinion—that question would be better addressed to the PBGC—but that my opinion was that a notice of sufficiency required a determination by PBGC that a termination had occurred.

Senator METZENBAUM. Who suggested paragraph 5 be included? Did you?

Mr. LILLY. I don't remember who suggested paragraph 5. I think that was a consensus agreement from the discussion amongst the various governmental officials involved.

Senator METZENBAUM. Were you involved?

Mr. LILLY. In that discussion?

Senator METZENBAUM. Yes.

Mr. LILLY. In Buck Chapoton's office. That is the meeting I was talking about, Senator.

Senator METZENBAUM. And were you involved in the drafting of this language, or had you seen this language, or did you approve this language, or did you have any involvement at all between AMAX and PBGC.

Mr. LILLY. As the letter from Mr. Jones indicates, Mr. Jones called me on the telephone and said, here is the language that the IRS says is OK with them, that we want to put into the agreement; from the policy perspective, does that language concern you, or would that language be OK with you? My answer was, that language seems to be the type of language that everybody in the meeting would agree would not bind the IRS if they wanted to make a different determination thereafter.

Senator METZENBAUM. So you were familiar with the language and you indicated that you had no objection? Is that correct?

Mr. LILLY. That is correct.

Senator METZENBAUM. Now, then, despite the agreement on the AMAX spinoff, the PBGC then writes to the Office of Fiduciary Standards, Labor Department, quote, that no notice of sufficiency is to be issued in spinoff cases, and it says that 20 such plans are pending before PBGC that involves spinoffs, and then it includes a list of 20 with the dollar amounts attached, indicated.

Is PBGC required to process these requests within 90 days?

Mr. LILLY. Is PBGC required to?

Senator METZENBAUM. Yes.

Mr. LILLY. PBGC's interpretation is that unless they get an extension, they should take action within 90 days, or the employer can act on its own.

Senator METZENBAUM. And have any of these 20 received notices of sufficiency?

Mr. LILLY. I don't know, Senator. You would have to check with the PBGC.

Senator METZENBAUM. Now, IRS then wrote to you on December 30 that it will refuse to recognize a termination in the AMAX case despite the PBGC agreement, and at that point IRS requested a meeting with you to be held on January 10, 1984. Is that correct?

Mr. LILLY. That is what is in their letter; that is correct, Senator.

Senator METZENBAUM. They say:

> We have concluded that in AMAX's case the plan was split into retired and active lives solely as a device to obtain a reversion, while permitting the employer to maintain its defined benefit plan. Under the code, assets in excess of present value of accrued benefits may not revert to the employer prior to a plan's termination.
>
> The split of the plan, coupled with the termination of only the retired persons, would be, in our view, a device designed to avoid the statutory nonreversion requirement. Accordingly, the termination would not be bona fide, and no surplus may revert to the employer.
>
> We also believe that although the PBGC settlement may decrease the extent of the abuse, it is fundamentally inconsistent with the substance-over-form doctrine.
>
> We would like to meet with you on Tuesday, January 10, 1984, at 9 a.m. in my office to discuss this case and agree on what actions should be taken.

That letter was addressed to you by Mr. Winborne, right?

Mr. LILLY. Correct.

Senator METZENBAUM. Did that meeting take place?

Mr. LILLY. No, it did not.

Senator METZENBAUM. Why?

Mr. LILLY. Because, as you will see in the first paragraph of that letter, Senator, it states that at that meeting you—meaning I—indicated the application of substance-over-form doctrine involved not only tax policy but pension policy in general, and you requested that such a policy should not be adopted before obtaining the Department of Labor's concurrence.

What I read from that very carefully is that the IRS had not adopted that policy finally, but wanted to have further discussions with it, and we were not able to get the necessary people together for those discussions on January 10.

The CHAIRMAN. I got Howard's attention with my teddy bear.

Senator METZENBAUM. I think that is a teddy bear that just joined our deliberations.

The CHAIRMAN. They are trying to soften my image a little bit with this teddy bear. But this is a T-bear, a T-bear that we will give to little children in hospitals so that doctors and nurses and hospital attendants will wash their hands and the child can say, "Hey, you can't touch my teddy bear or me without washing your hands," because we have been finding a lot of transmitted fatal diseases that have happened just because of that simple little problem.

Now, Howard, I wanted to bring some light to this hearing. That is why I thought I would bring the T-bear in here. [Laughter.]

But let me ask you this, Howard. Do you know how much longer you would be?

Senator **METZENBAUM**. Oh, I think I am good for at least a half hour to an hour.

The **CHAIRMAN**. Well, let me ask you if this would be acceptable to you. I think it is important for you to be able to ask your questions, but I also think it is important to note that, basically, we held the first hearing on February 8 of this year, and of course you took the majority of time there, which was your right to do.

We scheduled a second hearing for February 10, but it was canceled at your request.

I think Mr. Lilly has responded to all of the committee's questions, and he has met with you, as I understand it, as well.

Senator **METZENBAUM**. Yes.

The **CHAIRMAN**. We repeatedly asked your staff if they wanted another hearing, and we actually received no response over the last 3 weeks, so we just scheduled today's hearing in case you wanted another hearing.

Senator **METZENBAUM**. And I am here.

The **CHAIRMAN**. And you are here.

Senator **METZENBAUM**. And I am prepared to respond.

The **CHAIRMAN**. But even then, we did not receive a firm reply from your staff.

Senator **METZENBAUM**. I think we just received most of the material about 1 week ago, Mr. Chairman.

The **CHAIRMAN**. As I understand it, we have polled the committee informally, and we think there is support for Mr. Lilly.

I would like for you to be able to ask your questions. I wonder, since we have a major hearing that was supposed to start at 10 o'clock, if I could have you continue in the next room. Then you could ask all of your questions and get them in the record, and, of course, we will accommodate the media.

Senator **METZENBAUM**. I don't have any objection to continuing on——

The **CHAIRMAN**. Well, I would like to finish it this morning.

Senator **METZENBAUM**. But I don't think you can do it in that little room out there, Mr. Chairman. It is obvious that there is some interest. I don't know how many of these people are waiting for the next hearing or how many are interested in this.

The **CHAIRMAN**. How many people would be interested in this hearing? Can you raise your hands, please?

[Show of hands.]

The **CHAIRMAN**. OK, I've got about seven people who are interested in it.

I would suggest that you continue the hearing in the next-door room. We will keep the door open, and anybody who wants to hear, we will accommodate you to come in, because we just have this conflict and I have to get through these reauthorization bills.

So why don't we recess for 2 minutes and——

Senator METZENBAUM. Wait a minute. Mrs. Lilly, don't you want to come in?

The CHAIRMAN. Well, sure.

Mrs. LILLY. No, thank you; I have heard enough. [Laughter.]

Senator METZENBAUM. We would be glad to have you.

The CHAIRMAN. There will be room for Mrs. Lilly and anybody else.

Senator METZENBAUM. I am sure.

The CHAIRMAN. We will make room, and I know Senator Metzenbaum will accommodate you. Let's recess for a couple of minutes so we can clear this room, and if you will go to the back room, we will finish this up.

I don't see anything here that you need me here for, to be honest with you. Now, he has only gotten through one of his four points, as I understand it. So if you feel you need me as chairman in there, I will be happy to recess this hearing.

Senator METZENBAUM. Why don't you send the teddy bear over? [Laughter.]

[Short recess taken.]

The CHAIRMAN. Let's get this on the record. Mr. Lilly, you realize that you are still under oath from your previous hearing, don't you?

Mr. LILLY. I don't recall being sworn, Mr. Chairman.

The CHAIRMAN. Then perhaps we should take care of that.

Senator METZENBAUM. Yes, by all means.

The CHAIRMAN. Do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God?

Mr. LILLY. I do.

Senator METZENBAUM. And the answers you have given heretofore as well as those you will give are considered to be under that oath.

The CHAIRMAN. Now if you will excuse me, I will convene the other hearing.

Senator METZENBAUM [as acting chairman]. The hearing will resume.

Mr. Lilly, on January 9 and 10—I don't know why it is 2 days, but at any rate, the PBGC Board of Directors, Donovan and Regan and Baldrige, were sent a briefing document on spinoff terminations. Are you familiar with that document?

Mr. LILLY. Senator, I am familiar with a document dated January 9, 1984, which is a briefing document, but I am not familiar with the January 10 briefing document.

Senator METZENBAUM. For some reason, mine says January 10, 1984, and it reads:

> Memorandum for Hon. Raymond J. Donovan, Secretary of Labor and Chairman, Board of Directors, PBGC; Hon. Donald T. Regan, Secretary of the Treasury; and Hon. Malcolm Baldrige, Secretary of Commerce; Subject: Interim PBGC Policy in the Processing of Plan Terminations Pending and Adoption of Administration Policy Position re Excess Assets Cases.

Is that the one that you have? This was provided to us by you, but I want to be certain we are both talking about the same document. Would you like to see my document?

Mr. LILLY. Senator, if we provided it to you, I will have a copy of it here. It is just a question of finding it amongst all the documents we provided.

Senator METZENBAUM. Are they the same, the 9th and 10th documents?

Mr. LILLY. No; The document dated January 9 is the Pension Benefit Guaranty Corporation Board of Directors briefing document, Excess Asset Reversion Cases, dated January 9.

I believe I also provided to you the document dated January 10, and I am just trying to—I think that was an attachment to another document. I am just trying to find the document it was an attachment to. But I am familiar with that document as well, Senator.

Senator METZENBAUM. All right. Directing your attention to the January 10 document, on the fifth page of that, it refers to spinoff termination techniques. The second paragraph reads, "The PBGC has been reluctant to recognize this type of case as a valid termination of a plan."

In the third paragraph, it goes on to recite that the IRS position on this technique is that the termination should not be recognized for two reasons, and it then goes on to recite that the options available to the PBGC appear to be as follows: The first option would be to reject all submissions under the spinoff technique as not representing a valid filing with the PBGC under title IV. Such rejection would be in accord with the IRS position and would reflect the basic view that there has not been any termination of a plan in substance.

On the next page, page 6, it reads:

> A second option pending a final policy decision on the issues involved would have the PBGC proceed to deal with each case and try to obtain acceptable protective terms and conditions as was done with AMAX, Inc. See attachment.

Then skipping some:

> Accordingly, this option is not considered by the PBGC to be preferable to the first option.
>
> The third option is to recognize the spinoff termination technique as a valid technique of terminating a plan and recovering excess assets. This option is contrary to the Treasury/IRS position as presently expressed and to the position taken by the PBGC to date. From a legal viewpoint, given the IRS' present position—the legality of the option is questionable—it is not recommended by the PBGC.

Now, I would gather that you are familiar with that language that is contained in that document; correct?

Mr. LILLY. Correct.

Senator METZENBAUM. What decision was reached by the Board of Directors of PBGC?

Mr. LILLY. As I explained to you earlier, Senator, the PBGC Board of Directors has not met, to my knowledge, on this issue.

Senator METZENBAUM. What is the current policy, then, regarding the pending spinoff cases?

Mr. LILLY. The current policy is whatever the PBGC at this point is doing.

Senator METZENBAUM. What is that?

Mr. LILLY. I think that is a question better addressed to the PBGC, but my understanding is that the PBGC at this point in time is taking spinoff cases and attempting to get extensions of time on those cases past the 90-day deadline for responding to the request for a notice of sufficiency, and that in cases where they cannot do that, they are looking at the facts and circumstances of a particular case and making a determination on their own.

Senator METZENBAUM. And is it a fact that many of them are proceeding along the lines of the AMAX settlement?

Mr. LILLY. As I indicated to you earlier, Senator, I don't know what the answer to that question is. You would have to check with them.

Senator METZENBAUM. You did respond to that earlier.

Now, as you and I both know, Mr. Donovan is the Chairman of the PBGC.

Mr. LILLY. Correct.

Senator METZENBAUM. As the Acting Solicitor, you advise Mr. Donovan, correct? You are his legal counsel.

Mr. LILLY. I am not actually Acting Solicitor, Senator, because that, under the Vacancies Act, would not be appropriate. I am Deputy Solicitor for National Operations, who has had the Solicitor's duties delegated to him, to me, and I do provide legal counsel to the Secretary.

Senator METZENBAUM. And have you pointed out to him that without a PBGC policy position being enunciated, that the PBGC is acting in a sort of hiatus period?

Mr. LILLY. Since we are under oath now, I want to be accurate with regard to my answers, so it may take a little bit longer.

Senator METZENBAUM. I don't want to leave that negatively pregnant with the fact, Mr. Lilly, that if you weren't under oath, your answers would not be accurate. [Laughter.]

Mr. LILLY. No, I don't think that was negatively pregnant, Senator.

Senator METZENBAUM. I am sure it wasn't, but——

Mr. LILLY. But seeing as we are making more of an issue out of this than we were before, I think if you will refer to a memorandum dated December 21, 1983, which we have provided to you, you will see that I suggest to the Secretary that we do try to have a Board meeting at the same time that we proceed with discussion amongst all of the agencies involved to try to arrive at a solution to this particular problem if it is possible.

The Secretary indicated to us that that effort should continue, and he asked me to bring Mr. Monks into this discussion as the new administrator of PWBP as soon as that was appropriate, and those discussions are ongoing and have been very fruitful to date.

Senator METZENBAUM. And in your letter dated December 21, you attached a proposed memorandum from Mr. Donovan to the PBGC Board requesting the Board meet on an expedited basis to consider the issues raised in Ed Jones' December 9, 1983, memorandum to you, and you recommended that Mr. Donovan convene the Board to reach a final resolution of the issue. "Rather than wait until after the holidays to convene the Board, I suggest the memorandum be sent now so the Board can meet, at the latest, immediately after January 3." You also recommend that Bob Monks be immediately provided the relevant materials on these issues so that he can familiarize himself with the problems during the holidays, and "he and I can work as a team to develop DOL position." Correct?

Mr. LILLY. Correct.

Senator METZENBAUM. Well, let me go back a little bit. In light of the PBGC's position that it would not issue a notice of sufficiency on spinoffs because there was not a valid termination under title IV, how could you, as Secretary Donovan's adviser, permit AMAX to receive a notice of sufficiency?

Mr. LILLY. The notice of sufficiency, first, would be issued by the PBGC, not by the Department of Labor. The determination of whether or not PBGC ought to issue a notice of sufficiency again would be made by the PBGC, not by the Department of Labor, and those questions of whether they should receive a notice of sufficiency do not come through the Department of Labor channels; they are handled by the PBGC.

Senator METZENBAUM. Well, although you are not the PBGC counsel, it is a fact that you were the highest ranking official present from the Department of Labor in the discussions that took place at Mr. Chapoton's office, weren't you?

Mr. LILLY. I think that one of the other people in that meeting was also an SES person at my level, so I don't think that is accurate, no.

Senator METZENBAUM. But you were there as counsel to the Secretary.

Mr. LILLY. I think I was there as chairman of the working group the Secretary had put together, relying on the advice and counsel of the experts at the Department for their input in terms of the issue involved, and to bring to that meeting the Secretary's concern that pension policy be addressed as an overall matter, not from the narrow perspective of any particular agency.

Senator METZENBAUM. Well, it seems to me that that very much makes the point. You were there; policy resulted from that meeting; the PBGC was opposed to the IRS position; out of it came a settlement resolution of the AMAX issue; the letters concerning the settlement and the documents themselves were all submitted to you; and yet you tell us you had nothing to do with arriving at the AMAX settlement decision.

Mr. LILLY. Well, I think we have to get it into context, Senator. A couple of points. First, no policy emerged from that meeting, and no policy has yet been established with regard to the issue of terminations and reversions with regard to an administration-wide policy.

As I have indicated earlier, those discussions, the work and the analysis on that issue are still ongoing. I think that you will be participating, as I understand it, in a hearing on March 20, and I hope by that point—and I think all the other agencies hope by that point—that there will be a policy that we will be able to articulate and provide to you and discuss with you at that hearing.

But no policy emerged from the meeting at the Treasury Department, so I would disagree with you on that subject.

Senator METZENBAUM. By permitting the AMAX settlement to get through and working out the arrangement to do it, although that was not the enunciation of a policy statement, in effect it was a policy conclusion that was reached making it possible, under those prescribed terms, to put the AMAX termination through. Isn't that right?

Mr. **Lilly**. No; I don't think that is right. I disagree with that, Senator.

Senator **Metzenbaum**. Now, on February 10, you sent Mr. Donovan another memo on the issue of terminations, and in that you concluded that an economic study needs to be performed before a policy position can be taken.

Now, where do you find that in the law? Where do you find that kind of policy conclusion being reached, which is obviously going to take some time, and under what circumstances? You may think as an individual that that is right, but as a matter of law—

> Before we are in a position to decide finally among the available options, it seems crucial that we perform our own economic study of the ramifications of the possible options so that we act on the basis of hard facts rather than mere speculation.

And then you say at another point:

> We understand that a large number of employers are delaying plan terminations pending the enunciation of a Government-wide position with regard to reversions. Adoption of an interim solution may provide a "window" period which would unnecessarily encourage a rash of such terminations.

Now, my question to you is, you seem to be saying that if you provide an interim solution, that would unnecessarily encourage a rash of such terminations, but at the same time you are saying we need an economic policy study, which is, frankly, a delaying result, no matter how you slice it, because to make the economic study takes time, and doesn't that have the same impact? It provides for a window, in other words, a period of time between now until such time as a determination is made for a rash of terminations to be finalized.

Mr. **Lilly**. No; I don't agree with that, Senator. I think that the economic study is a responsible way to approach this problem because it is a very significant problem and one that impacts or could impact drastically, upon the pensions of America's working men and women.

I think for this reason that the conclusion reached by the Secretary, that he would direct the people at the Department to do the study with the data they had available as quickly as they could while the PBGC staff was advising us they were doing the same type of thing with the data they had available, was the responsible and the correct way to approach this, rather than to adopt an interim policy. Such an interim policy would go one way or the other toward encouraging or discouraging the establishment of pension plans and the termination of those pension plans, and result in an attempt to seek reversions while that was still a possibility and before a moratorium was imposed on the ability to terminate pension plans as ERISA currently allows. All of those things, added together, indicated that we had to move expeditiously, but that we had to move responsibly.

The working group that I chaired which prepared this memorandum came up with a recommendation that we should do an economic study because people out there were making many allegations about what was happening and the impact of this and the number of these terminations and the amount of participants who were being affected, but nobody had any hard facts. Those are the facts that we are now gathering.

Senator METZENBAUM. Did you indicate a moment ago that by March 20, the Department will have a policy position as to what should be done in connection with these terminations?

Mr. LILLY. What I said was that we are aware of the fact that the hearings are going to be held on March 20, and we are striving, to the extent that we can, in the Department of Labor, and working with the other agencies, to try to have a policy ready by that point.

Senator METZENBAUM. Do you think you will have?

Mr. LILLY. I don't know, Senator. I will have to see if we can get all the people together. It is a very difficult and, as I mentioned, complicated issue, and it is not one that lends itself to easy answers.

Senator METZENBAUM. When will the economic study be completed?

Mr. LILLY. The economic study is under way. We have gotten some preliminary figures together. It will probably be concluded, I would imagine, within the next week or two.

Senator METZENBAUM. And has an interim solution been adopted?

Mr. LILLY. By whom?

Senator METZENBAUM. By the PBGC.

Mr. LILLY. I don't know. You would have to check with the PBGC on that.

Senator METZENBAUM. Let me ask you, from your knowlege of this area, what abuses are taking place in pension plan terminations?

Mr. LILLY. From my knowledge of this area, I am not aware of abuses taking place with regard to pension plan terminations, because if we were, then we would be taking action with regard to the distribution of the plan assets. Our belief is that the termination of a pension plan by the sponsor does not itself constitute an abuse.

Senator METZENBAUM. Well, I am not suggesting that. I am saying, what abuses are taking place in connection with some or all of the terminations?

Mr. LILLY. Well, I am not aware of abuses that are taking place from the point of view of the Department's responsibilities under title I of ERISA.

Senator METZENBAUM. Do you think that pension plans that state that any surplus will go to the exclusive benefit of employees should be enforced? Do you think the Labor Department has any responsibility in that respect?

Mr. LILLY. Section 4044 of ERISA requires that a termination take place in accordance with the plan documents. If that provision is in the plan and it is not enforced, then it would be up to the PBGC to make sure that it is enforced.

If the distribution after termination takes place does not provide for the assets to go to the employees in accordance with the provisions of the plan, then the Department of Labor would become involved and would take action in that regard.

But if the plan is amended prior to its termination, which is also perfectly appropriate under ERISA, then that would not apply.

Senator METZENBAUM. Well, that leads me to my next question. Should an employer be able to amend such a plan to permit a reversion and, within the next 24 hours or so, terminate it, take the surplus, even when he has promised in the pension plan not to take the surplus? As you probably well know, that is what happened in the *Graniteville* and the *Washington Star Pension Plan* cases. Does the Labor Department have a responsibility to act to prevent that from happening?

Mr. LILLY. Senator, I think it would be presumptuous of us to substitute our judgment for that of the elected representatives in the U.S. House of Representatives and the Senate. They are the ones that put the provision into ERISA that said that the plan could be amended at any point in time, and that plans could be terminated by the employer at any point in time.

When you put those two provisions together, as the district court did in the *Harper and Rowe* case, with which I believe you are familiar, the court ruled that that was perfectly appropriate and not illegal under ERISA.

Senator METZENBAUM. Do you think Congress should change the law in that respect to provide better protection for the employees?

Mr. LILLY. I think the Congress has to balance very delicately the question of whether or not, if they set up a system that does not permit the amendment of pension plans, whether or not employers will continue to set up pension plans and whether employees will be worse off because of the absence of such pension plans and protections for their retirement.

Right now we have a golden goose, I think, with regard to the pension plans. Corporate America has set up enormous pension plans with very generous benefits for the workers all over this country. To come in now and say, We are changing the system so that once you put a plan into place, you are not going to be able to amend it no matter what happens, no matter what might result from the collective bargaining process, I think would be detrimental at this point in time to both the workers and to the pension system. This would make it less likely that employers would establish pension plans in the first place.

Senator METZENBAUM. Mr. Lilly, you are a fair-minded man. Assuming you get confirmed as Solicitor of the Department of Labor, if Congress asks your advice, as I am now doing, as to whether or not there ought to be some amendment of the law which would preclude the right to make an amendment of a plan that provided that the surplus is to go to the employees, and then, immediately thereafter, take the funds for the employer, would you not think that there was some action, some changes that should be made in the law?

Mr. LILLY. In addition, hopefully, to being fair-minded—and I thank you for that, Senator—I am also humble, and I will tell you that that is something that I do not have the expertise in to sit here and say, Yes, that is what ought to be done, or no, that is not what should be done.

What I would recommend—and I think that you are going to engage in it beginning on March 20 and thereafter in Senator Nickles' hearings to address this problem—is that this is exactly the type of issue we have to analyze with the facts in hand as to whether or not large numbers of terminations are taking place; is there in fact a rush to this type of activity? Our figures to date indicate that there is not; that a very small number of plans, defined benefit plans, are in fact being terminated, with a minuscule amount of assets compared to the overall value of the assets in defined benefit plans reverting to the employers.

So again, I would say that that is something that those people with the expertise, through the hearings that you will be participating in, those kinds of facts have to be brought out. However, at this juncture, I could not say whether or not I think that such a provision ought to be enacted.

Senator METZENBAUM. Mr. Lilly, at an earlier point in this hearing, and now again, you have indicated that a minuscule number of plans are being amended——

Mr. LILLY. Excuse me. Terminated.

Senator METZENBAUM. Terminated.

Mr. LILLY. Relative to the overall universe of plans.

Senator METZENBAUM. I would just like to point out to you that compared to the number of banks in this country, there is a minuscule number of banks that are being held up and robbed today, but that doesn't mean you don't have laws to keep it from happening. And I would have to say to you that I think that that is a very illogical point when you are talking about $500 million going out the door and another $500 million about to go out the door, and to say, well, that is minuscule because $1 billion as compared to the total universe of pension plans is considered to be minuscule.

I might point out to you, my staff just advises me that since we have last looked, the amount has gone up and that there is a billion dollars in terminations pending, so that billion dollars is related to whatever the number is in the totality. Despite the fact that that is a very minuscule percentage, it seems to me, the issue is still very relevant; and particularly, if you were one of the ones looking toward obtaining a pension or being covered by the plan as far as your future is concerned.

Mr. LILLY. I would probably be the last to say that my logic never fails, but at the same time, I think that when one is addressing a particular problem and beginning to examine it, one has to look at the scope of the issue involved, and the reasons are multiple for the termination of plans, and ERISA provides for the termination of plans for a variety of reasons.

Businesses are coming into existence and going out of existence on a regular basis, and there is no way that a plan, when it is initially set up, can be etched in stone to remain there forever, because that is not the way the business world works. If the business goes out of business, there goes the plan.

The issue that I am talking about is, I think that when the facts are assembled before the committee and before the House, as they start to look at this issue and as they have been, I think that it will become apparent that the amount of money that is put in on a daily basis to these plans, private pension plans, will make the amounts that have gone out through the terminations appear in your own eyes, Senator, to be minuscule. What one has to look at is not the figures alone of how much has gone out in assets as a result of terminated plans, but rather, what is the system we are dealing with? And the enormity of the system we are dealing with is mind-boggling. Some have referred to it as the largest single pool of capital in the entire world. We are talking about literally trillions of dollars in these types of plans.

So again, I would say that we have to take a look at the overall picture, not just at the number of plans being terminated or the dollars in those particular plans.

Senator **METZENBAUM**. Well, you know, I guess one of my concerns with your appointment does not relate to—well, it does relate to your continued concern about the employers and whether employers will participate, and what will happen to employers and how it will affect their judgment.

It is rather evident throughout your testimony, both the other day and in my meeting with you today that almost with no exception, I do not hear you addressing yourself to your concerns about the employees and the beneficiaries of these plans.

I think you have pretty well indicated, proven, that you might be an appropriate solicitor for the Department of Commerce, speaking for business, but I must say that it is disturbing to me that the Department of Labor has brought in a corporate lawyer to advise in connection with the Department of Labor's activities, and that there is no sensitivity indicated to the employee problems.

Now, it is only fair to say that, the Department of Labor has probably in previous instances gone to the corporate law firms and found lawyers who became the counsel to the Department of Labor. But I just wanted to share with you my feeling that there is not that sensitivity, there is not that concern, there is not that awareness of the problems of the working people, those who hope to go on pensions or those who are on pensions. You may have it, but it hasn't been evident, Mr. Lilly.

Mr. **LILLY**. Well, I would have to disagree with that, Senator, and think that a fair reading of this transcript will indicate that my concern throughout, and the Secretary of Labor's concern throughout, has been the protection of the pension system for the American working men and women, not for the corporations. But you are not going to have a pension system for the American working men and women, or you are going to have a bankrupt system, as the allegations have been made about the social security system, if private employers are not putting that money in.

The money does not come out of thin air. It comes out of the employers' coffers. Agreed, there is a system set up to provide for tax deductions, to provide incentives for that sort of thing. But the employers do not have to set up these systems. And in order to have these systems set up, in order to provide the working men and women of America with these types of pensions, it is only going to happen if the employers do it, and what we are trying to do is make sure that the system which you all set up under ERISA continues to function effectively as you all have set forth in the law that it will function, providing for all of the things that you all provided for in ERISA.

Our main concern at the Department of Labor, as I indicated on numerous occasions, is to protect these pensions for the American working men and women.

Senator Metzenbaum. Mr. Lilly, you have said that several times in the past, that employers will not participate, that employers will not want to set up these plans. What evidence do you have to support that statement?

Mr. Lilly. I don't think I have said "will not." I said "may not."

Senator Metzenbaum. All right.

Mr. Lilly. And the evidence, I think, for that is clear that we have had numerous indications by people testifying before Congress that if significant changes are made—and I think if you take a look at the legislative history of ERISA, it became very apparent during the hearings on the establishment of ERISA that ERISA, if it was not a voluntary program, would be a program that not many companies would get involved in.

Senator Metzenbaum. Nobody is suggesting changing the voluntary aspects of it. I haven't suggested that, and I don't know of anybody else in Congress who has suggested that.

What we are talking about is whether or not there ought to be some proscriptions with respect to the amending of plans and then using the funds for leveraged buyouts, to fund acquisitions, or to play a role in fending off possible takeover attempts.

That is what we are talking about, and you cannot tell me that any of the people who have been involved in these undertakings really are representing the great body of the American corporate world. You keep saying that employers will not participate; employers will back off; and I say to you, what evidence do you have? You tell me about some hearing that was held 10 years ago. Tell me what evidence you have that employers will back off if we change some of the rules with respect to the termination of plans and taking the surplus out.

Mr. Lilly. I think that the appropriate forum for obtaining that type of evidence to evaluate those types of changes is exactly the type of legislative hearings that you are proposing and Senator Nickles is proposing to hold and the House is proposing to hold.

We don't purport to represent, as you have indicated, the corporations of America. I am sure they will be able to do that on their own and do it adequately. What I am telling you is that we have had discussions with people who have indicated that significant changes to the ERISA system accomplished administratively will result, could result, in serious problems with regard to the employers' and the employees' community in general.

Senator Metzenbaum. Mr. Lilly, I have some questions concerning another subject. They concern important documents which were the subject of a congressional investigation.

As you know, Congressman Miller, chairman of the House Subcommittee on Labor Standards, held a hearing on November 1 last year concerning whether meetings between the OSHA staff and representatives of private industry may have had undue influence on OSHA's establishment of health standards with respect to a hazardous chemical, ethylene oxide.

In that hearing, Dr. Vance, the director of health standards for the Occupational Safety and Health Administration, testified that he maintained logs of meetings and telephone conversations. He also stated that he "would be very happy to show you personally, show the chairman, show any Congressman, my entire set of logs."

That same day, following the hearing, subcommittee staff met with Dr. Vance to discuss obtaining the documents. Negotiations continued until they appeared to reach an impasse.

On November 10, Congressman Miller was forced to again formally request the documents. On November 14, Thorne Auchter, Director of the Occupational Safety and Health Administration, responded that the Department was still reviewing the documents.

Congressman Perkins, chairman of the full House Education and Labor Committee, and Congressmen Gaydos and Miller, in order to emphasize the importance of these documents, requested the materials again on November 16. They indicated they were prepared to subpoena the documents if necessary.

While the Department on November 14 indicated that they were reviewing the documents on an expedited basis, it was not until February 2 that the Department told the committee that it would not provide the documents.

The bottom line, Mr. Lilly, is that the agency refused to provide the documents as requested, and it is now my understanding that three of the four documents have been destroyed.

Mr. Lilly, we have a situation in which documents were the subject of a congressional investigation, and they were not provided, and it appears that you were the person responsible—or, as the case may be, irresponsible—in performing your duties as Deputy Solicitor.

Perhaps we can find some explanation. But your written responses to my questions certainly were not satisfactory, particularly given the gravity of the situation.

Mr. Lilly, when was the Solicitor's Office asked to review the subcommittee's request, and who made the request?

Mr. LILLY. I would have to estimate the time, Senator, because I am not sure of the exact date.

Senator METZENBAUM. That is fair enough; that is all right.

Mr. LILLY. I think we were probably asked to take a look at those documents sometime in mid to late December.

Senator METZENBAUM. And why was the request made, when Dr. Vance indicated his willingness at the subcommittee hearing to provide the documents? Who asked you to review the subcommittee's request?

Mr. LILLY. The request was made, Senator, because the committee and Chairman Miller of the subcommittee addressed correspondence to the Assistant Secretary of Labor asking him to produce the documents.

Obviously, the Department of Labor official can only produce documents which are official Department of Labor documents, and as a result of the discussions that Mr. Auchter presumably had with the people, Dr. Vance or others, he asked me and the Solicitor's Office to take a look at the documents and make a legal determination for him as to whether those documents were official OSHA records and documents; that is, were they personal documents? That is the request that was made to me.

Senator METZENBAUM. Was OSHA looking for a reason not to provide the documents to the subcommittee?

Mr. LILLY. You would have to ask OSHA that, but I have no indication of that whatsoever. They were looking to comply with the law and avoid trying to force an OSHA career employee, a government career employee, to turn over personal documents to OSHA that in fact were not OSHA records. That would be illegal.

Senator METZENBAUM. You say personal documents. Didn't this have to do with the logs that Dr. Vance had maintained?

Mr. LILLY. Senator, the document that I reviewed, that was provided to me by Mr. Vance at Mr. Auchter's request, was a notebook purchased at People's Drugstore by Mr. Vance, according to him, in which he kept notes of everything that he did during the day, during particular periods of time.

These included telephone conversations, meetings, et cetera, including notes on telephone conversations he had with his doctors and his family about his mother's terminal cancer and a number of other things.

Upon reviewing the documents and upon the information provided to me by my staff, as well as my review of the cases, the applicable case law, and the rules and regulations of the Department of Labor, it was clear to me that these documents did not fall within the guidelines of what were official OSHA documents, official Department of Labor documents, and that is what I advised Assistant Secretary Auchter.

Senator METZENBAUM. If the director of health standards for OSHA has a log indicating that he met with corporation X and corporation Y and maybe union official Q, and although he puts it in a People's Drugstore notebook or some personal notebook that contains a number of other documents, a number of other notations of a personal nature, are you telling this committee that that information is private and that it cannot be made available to a congressional subcommittee or committee?

Mr. LILLY. I think one thing we ought to point out is that the document has been made available to the subcommittee and that the chairman has that document and he received it from Dr. Vance.

Senator METZENBAUM. All four documents made available, or one document?

Mr. LILLY. The document that I looked at.

Senator METZENBAUM. What about the other three?

Mr. LILLY. I don't know what the status on the other three documents is. Dr. Vance has provided the document that I looked at to Chairman Miller. However, the question before——

Senator METZENBAUM. Did you tell the subcommittee that two of the documents were destroyed?

Mr. LILLY. Excuse me?

Senator METZENBAUM. Did you tell the subcommittee that two of the documents were destroyed?

Mr. LILLY. I believe that I told John Galloway, of the subcommittee staff, that it was our understanding that two of the documents had been—were not available, and whether or not they had in fact been destroyed or were just unusable, I am not sure.

Senator METZENBAUM. You only saw one of the documents?

Mr. LILLY. That was all that was provided to me by Dr. Vance, and I was asked to review that document as to whether or not that would be considered an official OSHA record or a personal document. Under the applicable legal criteria, it was clear that the cases decided by the courts and the principles established in those cases would clearly classify this document as a personal document, not an official document.

Senator **Metzenbaum**. A document containing a record of a public official meeting with a private person having to do with an issue of policy in the jurisdiction of that individual, and you say that is a private document?

Mr. **Lilly**. Senator, if I can answer that one by example, if I were to keep my personal notes of these meetings that have taken place, other meetings with you, meetings with people, with the Secretary of the Department, I kept all of those on my own; I did not give those to my secretary for typing or for any other purpose; did not make them part of the agency records; and did nothing with them of an official nature such as quote from them in terms of the official documents passed back and forth among departmental officials, those documents would in fact be personal documents, and the courts have so ruled.

Senator **Metzenbaum**. Isn't that only true with respect to freedom of information requests but is not the law with respect to documents that have been requested by a congressional committee?

Mr. **Lilly**. The issue that was presented to me by the assistant secretary was whether or not these documents were official documents or personal documents.

The procedures by which congressional committees obtain documents vary between official documents and personal documents. They made a request of Mr. Auchter. Mr. Auchter made a request of me to determine whether or not he could produce those documents. The legal opinion I provided to Mr. Auchter was that these were not official OSHA records.

Mr. Auchter advised the committee that they ought to get in touch directly with Dr. Vance because he did not have the authority to turn these documents over which belonged to a private citizen who was a career Government employee, and that is how the analysis was done.

The courts that ruled on this issue did rule, as you have pointed out, on a Freedom of Information Act request, but the ruling was with regard to whether or not the documents were official documents or personal documents, and if they were personal documents, they were not subject to FOIA, and the court ruled that under the criteria, these were personal documents, not official documents.

Senator **Metzenbaum**. But I am making the distinction between FOIA and a congressional request.

Mr. **Lilly**. The congressional request, though, Senator, has to go through the right channels, and if they are official documents, then they will be turned over to the congressional committee in response to any congressional request. But we cannot force, I cannot force one of my staff members to turn over their personal letters, and we cannot, in a request to me from a U.S. Senator or a Member of the House of Representatives, force those people to turn over their personal documents.

Senator **Metzenbaum**. Dr. Vance indicated to the committee he was willing to turn over all the records; in fact, he urged them to ask him for them. His quote was, he also stated he would be "very happy to show you personally, show the chairman, to show any Congressman, my entire set of logs."

But after Dr. Vance, through Auchter, goes to Lilly, the logs don't come.

Mr. **Lilly**. No, I don't think that is accurate, Senator. I think what happened was, Chairman Miller decided that what he was going to attempt to do was force or ask the Assistant Secretary for OSHA to produce those documents, because then they would have become, through that process, official OSHA records.

Assistant Secretary Auchter said, "Are these documents which I as the Assistant Secretary can produce?" In response to that, my legal opinion was, those are not official OSHA documents, and no matter how we treat them, they will not become official OSHA documents by magic. They are not; they have been created; they are in existence; and they are treated by the individual as his personal documents, and they are personal documents. Therefore you, Mr. Auchter, have no legal authority to produce those.

Senator **Metzenbaum**. Did you know that for 2 weeks the Congressman's staff had been negotiating to obtain the documents, and the only basis on which Congressman Miller requested the documents from Auchter was after 2 weeks of negotiations?

Mr. **Lilly**. I did not know that.

Senator **Metzenbaum**. All right, but the point that I am making is that Dr. Vance was willing to turn over the logs, proposed turning over the logs, and by the time it gets through the screening process, the Acting Solicitor for the Department of Labor issues an opinion that says it is based on FOIA decisions, not upon decisions of the courts with respect to congressional requests, and comes to the conclusion that they will not be made available.

Mr. **Lilly**. No.

Senator **Metzenbaum**. One of them is finally made available, and Congressman Miller's staff, I am told, was informed that two were destroyed by a dog; the third is lost or stolen. [Laughter.]

Now, the question really has to do with credibility in Government, and it appears on its face, whether you were directly or indirectly involved, that you were a participant in keeping Congressman Miller's staff from obtaining logs having to do with Dr. Vance's meetings with industry representatives that he was very willing to make available, and that after it got through you, they were no longer being made available. That is the appearance, whether it is correct or not.

Mr. **Lilly**. Well, I don't think that is the appearance, Senator, because the log has been made available. When the issue came to me, I was provided with one log, and the issue there was simply with regard to a request by a Member of Congress for a document, can a Department of Labor official provide that document if it is not an official document, and the legal response to that answer is no, they cannot force that person to turn over that document to them in order to turn it over to a committee.

Senator **Metzenbaum**. Did you know that Vance was willing to turn it over?

Mr. **Lilly**. No. I was not party to any of those discussions.

Senator **Metzenbaum**. You never heard that Dr. Vance made that statement that I read to you?

Mr. **Lilly**. No; I never heard that. What I was told later was that after Mr. Auchter advised the committee and after I spoke to Mr. Galloway and sent the letters to Chairman Miller explaining the basis for the legal opinion, that thereafter, when the committee got back in touch with Dr. Vance and essentially said, "We can't get it from Auchter; will you give it to us?" he said yes.

Senator **Metzenbaum**. What about the other three documents? Why didn't you ask to see all four of the documents?

Mr. **Lilly**. Because I had no idea that four documents existed. I was told that this was the diary.

Senator **Metzenbaum**. Do you recognize that there is a difference between Freedom of Information Act requests and congressional committee requests?

Mr. **Lilly**. Certainly.

Senator **Metzenbaum**. And yet in the brief that you relied upon, you relied upon decisions made having to do with FOIA cases, didn't you?

Mr. **Lilly**. Well, the principles that were discussed in those decisions were principles applicable to whether or not documents were official documents or personal documents, and those decided principles were the principles that I relied upon for making that determination.

The determination of whether or not the documents would be turned over was a determination made by the Assistant Secretary, not by me.

Senator **Metzenbaum**. Say that again.

Mr. **Lilly**. The determination of whether or not the documents would be turned over was a determination made by the Assistant Secretary, not by me.

Senator **Metzenbaum**. Isn't it a fact that you were one of the few people in the Department of Labor to review the logs, and in light of the subcommittee's fears about undue influence and improprieties and closed-door meetings, it would seem to me that an individual who wants to be Solicitor of Labor would want to examine all of the logs carefully to determine whether or not there was any evidence to support the committee's fears.

Did you conduct such an examination, and wasn't there any natural curiosity about the validity of the committee's concerns?

Mr. **Lilly**. Well, I think that natural curiosity, as they say, killed the cat. The point of view from which I was viewing these documents at the request of the Assistant Secretary was to determine whether or not they were official OSHA documents or personal documents of Dr. Vance.

At the same time, however, after talking with Mr. Galloway, I was mindful of the subcommittee's preconceived notion that Mr. Vance, Dr. Vance, had participated in a number of ex parte proceedings.

As we pointed out in the letter to Chairman Miller, obviously, any such actual indication in the diaries pointed out to us by the subcommittee or anyone else would be immediately addressed, appropriately. The question of what constitutes an ex parte contact, as I am sure you are aware, Senator, is very complicated in regard to the rulemaking procedures that apply with regard to OSHA rules and hybrid rulemaking.

Nevertheless, out of an abundance of caution, I asked people on my staff, a person on my staff whose judgment I trust implicitly, and who is much more familiar with the ongoing activities of OSHA to take a look at this document from that perspective, and he did so, and he provided the opinion to me that he did not see any problems with regard to that.

Senator METZENBAUM. I think we find another instance, Mr. Lilly, where your position as Acting Solicitor effectively keeps information from a congressional committee that was engaged in a very proper and appropriate pursuit concerning OSHA activities.

In each of the instances which we have discussed, there is what I would consider that failure to appreciate the sensitivity, the impact, the need to be more forthcoming. You may have acted within the letter of the law, but I have difficulty in concluding that you acted appropriately to see to it that there was the kind of cooperation that Dr. Vance was willing to provide, but after it went through the procedures at the Labor Department, you in effect came down with an opinion that would have kept him, could have kept him, from making the information available. But the fact is that Dr. Vance was willing to make the information available, and so it was, but the other three documents never were made available, and I am not in a position to comment on your own involvement in that because you indicate that you didn't see the other three documents, although I don't know why; you could ask to see them.

You can respond if you want. You don't have to.

Mr. LILLY. I would like to respond along the lines that I think one of the most important principles that we are dealing with is that we are a government of laws and not of men, and that if we wanted to get into the business of deciding when things do not go according to legal procedures but rather when we will make career government civil servants turn over to political appointees or other people in the Government their personal documents, I think we are embarking on a very, very dangerous course.

Senator METZENBAUM. I wish you had taken the same position with respect to the AMAX question.

Mr. LILLY. I have taken the same position right along, that we are a government of laws, not of men.

Senator METZENBAUM. I think it was just opposite of what you just said.

Mr. LILLY. I don't think so, Senator, and I think that the Assistant Secretary was acting perfectly appropriately in asking for a determination of whether or not he could force a career Government employee to turn over to him for turning over to the House committee documents, and when he asked me for that legal opinion, I think it was appropriate and responsible for me to analyze that objectively, not from the point of view of did we want to keep peace with Congress or did we want to have a fight on our hands, and I think that is my responsibility.

Senator METZENBAUM. Mr. Lilly, I am going to ask you a few questions in followup to my written questions to you about the majority staff report of the House Subcommittee on Labor-Management Relations concerning the enforcement of the Landrum-Griffin Act.

My questions concern changes in legal interpretation in which the solicitor's office presumably had a role. In response to my question as to the Department's abandonment of direct theory cases, cases in which consultants undertake activities behind the scenes, you stated that such cases are typically in the nature of advice.

Even assuming that most cases typically do fall in that category, what about the cases which do not fall in this category, where you have abandoned all the cases of this nature?

Mr. LILLY. What about those? I don't understand the question.

Senator METZENBAUM. Let me go on.

The subcommittee staff report—what I am asking you is the following: How do you explain your position with respect to the Department's abandonment of indirect theory cases—that is, ones involving consultants who undertake activities behind the scenes—and you indicated that those matters are normally, typically, in the nature of advice?

Now, the question that I have is, Do you not see the impact that that behind-the-scenes consultants' advice has upon the labor-management relations and does have an impact upon the application of the Landrum-Griffin Act?

Mr. LILLY. I think that one of the problems we are all facing with regard to our activities in Government is an effort to accomplish as much as we can and carry out the enforcement responsibilities that have been assigned to us with the limited resources that are available because of the very nature of a government activity that has to be paid for by someone else.

The LMSA organization, Labor Management Services Administration, in the Department of Labor made a determination that they had only so many resources with which to carry out their enforcement responsibilities under the LMRDA. They made a determination that the most important cases that they had to pursue and on which to enforce the LMRDA were the direct contact cases.

That position, that policy determination by LMSA and the Department of Labor was challenged in court. Judge Greene indicated in the *Kawasaki* case that those types of determinations are clearly defensible and rational; that you have to determine, with the resources you have, what you are going to do.

That was not a determination made by the Solicitor's Office. I really don't think it would be appropriate for me to comment on whether or not I would have done that had I been in LMSA.

The question from the solicitor's office's point of view was, was that legal or not? and the answer is "Yes," it certainly was legal for them to make that policy determination, and they were not abdicating any responsibility under the LMRDA, nor was the Department of Labor.

Senator METZENBAUM. The subcommittee staff report also notes that the Department has implemented a policy of opening cases directed at employers only when a complaint is filed. On the other hand, cases directed by unions are not similarly restricted.

How do you justify this fundamental change in policy?

Mr. LILLY. I think you would have to ask LMSA how they would justify the change in policy. The question, to the extent the solicitor's office would become involved, would be simply a question of whether or not it was legal for them to do that.

Senator **Metzenbaum**. Do you think so as Solicitor?

Mr. **Lilly**. Excuse me?

Senator **Metzenbaum**. Do you think that it is legal for them to make that distinction?

Mr. **Lilly**. Yes; I think it was legal within the confines of the LMRDA; that it was a policy discretionary decision that they could make.

Senator **Metzenbaum**. Do you think it appropriate? If you were asked for your advice as to whether they should only act when a complaint is filed against employers but have a different policy with respect to when they will act against unions, would you——

Mr. **Lilly**. I think that any analysis like that, Senator, would require an examination of the facts and circumstances surrounding the complaint process, surrounding the resources available to the LMSA, and that I would not want to opine at this point on whether or not it was appropriate at that point in time.

Senator **Metzenbaum**. How can you claim that that is an evenhanded approach to the law?

Mr. **Lilly**. I think it is an evenhanded approach to the law, Senator, because they are doing what the people in Congress in their wisdom directed them to do; and that the evenhandedness results in the way they enforce the responsibilities assigned to them by Congress, not in determining on their own, as we talked about a moment ago, arbitrarily and capriciously, that they are going to take some particular type of action or not take some particular type of action.

This was a judgment made by them based on the amount of resources they had and that they could bring to bear on this particular problem, and that determination and that allocation was upheld by Judge Greene as being perfectly rational and defensible.

Senator **Metzenbaum**. And you think for the Labor Department to follow that procedure is perfectly good policy as well as legal policy?

Mr. **Lilly**. As I mentioned before, I don't think it is appropriate for me to comment on the LMSA policy. I think that is what LMSA was doing in terms of testifying before Chairman Clay's subcommittee.

I do think that from a legal perspective we have to make a determination for these agencies of whether or not what they are proposing to do is legal under the particular act in question. In the LMRDA question, we made a determination that their approach was within the confines of the law and that they had to make the policy determination and figure out where they were going to put their resources.

Senator **Metzenbaum**. Thank you, Mr. Lilly.

That concludes this hearing.

Just a moment—subject to recall of the chairman. The chairman has a right to call you back, and I would assume that if any of the members had any questions, you would be willing to respond to those questions at the hearing.

Mr. **Lilly**. Certainly.

[Mr. Lilly's response to written questions from Senator Hatch and Senator Metzenbaum and additional material supplied for the record follow:]

U.S. Department of Labor

Office of the Solicitor
Washington, D.C. 20210

MAR 9 1984

Honorable Orrin G. Hatch
Chairman, Committee on Labor
and Human Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Enclosed please find my answers to the written questions you and Senator Quayle submitted to me on February 8, 1984. If I can provide additional information, I will be happy to do so.

Sincerely,

Francis X. Lilly

Francis X. Lilly
Deputy Solicitor of Labor

Enclosures

cc: Senator Quayle

1. In your statement, Mr. Lilly, you touch briefly upon the various suits that the Labor Department has filed against the Teamsters' Central States Pension Fund and related defendants. Would you explain the status of the suit or suits involving the late Alan Dorfman and the companies that he controlled.

ANSWER:

Part of the primary litigation involving the Health and Welfare Fund went to trial beginning Monday, February 6, 1984, in Chicago before Judge Hubert Will. This aspect of the Donovan v. Robbins and Donovan v. Dorfman litigation seeks to resolve which assets owned by corporations controlled by Allen Dorfman before his death last year are needed by the Health and Welfare Fund to process its claims on an in-house basis, as well as how much of the $10.75 million which the Fund has paid into the registry of the court is permissible payment under ERISA for these assets. On December 29, 1982, shortly after a jury returned guilty verdicts against Mr. Dorfman and others for conspiring to bribe a United States Senator in a scheme involving property owned by the Pension Fund, we broke new ground under ERISA by securing an order appointing a receiver for, and freezing the assets of, Mr. Dorfman and his corporation, which were responsible for processing claims for the Health and Welfare Funds's 500,000 participants and beneficiaries. The receivership remained in place until after Mr. Dorfman was slain on January 20, 1983, and was replaced by an Agreed Order, entered on February 1, 1983.

This order provided for an immediate turnover to the Health and Welare Fund of the resources required for it to process claims on an in-house basis. Under the provisions of the Agreed Order, no payment can be made to the Dorfman interests until after the trial of all of the Secretary's claims, with any judgment entered against the Dorfman interests operating initially as an offset to the amount that otherwise would be payable for the claims processing assets of the Dorfman corporations. We anticipate that the Secretary's remaining claims in the Robbins v. Dorfman cases, which allege that the Dorfman corporations illegally received millions of dollars in overpayments for claims processing services, will go to trial shortly after the court decides which assets of the Dorfman corporations are required by the Health and Welfare Fund to process claims and the appropriate payment for those assets under ERISA.

As for the efforts to resolve our differences with the current trustees of the Pension and Health and Welfare Funds, we are continuing to explore ways to implement the May 1983 agreements I referred to in my prepared statement, and we are hopeful that we will succeed promptly.

2. Would the Labor Department's enforcement efforts over the last two years have been more successful if Congress had passed the Labor Management Racketeering Act, S. 336?

ANSWER:

Simply stated, Mr. Chairman, Yes. The Senate just recently passed for the fourth time the Labor-Management Racketeering Act for which you have been fighting tirelessly. Had that bill been the law at the time of the convictions of Allen Dorfman and the others for the conspiracy to bribe a United States Senator with Teamsters' Central States pension fund assets, protections for the Plans which took us literally months to negotiate as part of the Consent Decrees, would have been implemented without this enormous effort.

3. As I am sure you recognize, Mr. Lilly, there is more than a little confusion in Congress as to which agency or department has authority for investigating civil and criminal violations of the Labor-Management Reporting and Disclosure Act and the Employee Retirement Income Security Act. Would you please explain for the record what you perceive to be the existing division of authority for investigating these statutes among the Labor-Management Services Administration, the Inspector General's Office of Organized Crime and Racketeering and the Department of Justice.

ANSWER:

The Department of Justice (DOJ), as the only agency with authority to invoke the grand jury process, is in the lead of the joint efforts that are pursued to investigate alledged criminal violations of the Labor-Management Reporting and Disclosure Act (LMRDA) and the Employee Retirment Income Security Act (ERISA). As appropriate, however, the Labor-Management Services Administration (LMSA), the Department of Labor's Inspector General's Office of Organized Crime and Racketeering (OOCR), and DOJ all investigate alleged criminal violations of LMRDA and ERISA, as well as related Title 18 offenses, in a manner that takes into account the special responsibilities, expertise, and resources of respective investigating entities.

For example, to the extent possible criminal violations are uncovered in the course of LMSA's civil investigate efforts under LMRDA and ERISA and appear to involve subjects of possible interest to those responsible for combatting organized crime, this information is referred at the field office level to the appropriate DOJ Organized Crime Strike Force, often through the OOCR agents who coordinate their efforts with the DOJ Strike Force attorneys.1/

1/ In 1978, Secretary of Labor Ray Marshall established the Office of Special Investigations (OSI) in the Department of Labor (Secretary's Order 8-78, dated June 13, 1978). OSI was given the authority to administer the Department's participation in the organized crime and labor racketeering area. In enacting the Inspector General Act in October 1978, Congress "transferred ... to the Office of Inspector General of the Department of Labor ... the Office of Special Investigations...." (section 9(a)(1)(E of the Act). Thus, the new Office of the Inspector General within DOL subsumed the duties of OSI.

DOJ then decides what investigation is appropriate and whether it should be delegated to OOCR or undertaken by the Federal Bureau of Investigation (FBI).

When possible criminal violations of ERISA are uncovered that do not appear to involve organized crime subjects, this information is referred by the LMSA field office to the appropriate United States Attorney, usually with a request that criminal investigative responsibility be delegated to LMSA. DOJ then decides how any investigation will proceed.

Pursuant to a 1960 memorandum of understanding between the Departments of Justice and Labor, LMSA investigates possible criminal violations of the LMRDA involving reporting, trusteeships, bonding, making of excessive loans to union officers and employees, and payments by a labor organization of fines of officers and employees convicted of violations of the LMRDA. The Department of Justice, under delegation from the Secretary of Labor in the memorandum of understanding, is responsible for investigating possible criminal violations concerning embezzlement of union funds, payments by employers of fines of officers and employees convicted of violations of the LMRDA, prohibition against certain persons holding office, prohibitions against certain payments to union officials, and the deprivation of members' rights by force and violence. However, when LMSA field offices uncover evidence of possible embezzlement of union funds, this information is referred to the appropriate United States Attorney with a request that investigative responsibility be delegated to LMSA.

Within the Department of Labor, LMSA and OOCR routinely exchange information on investigations that are planned or underway, as well as on other matters, so aso to coordinate their efforts. The only limitations on these information exchanges are those specifically required by law, such as the confidentiality provisions respecting tax returns and return information found in the Internal Revenue Code and the grand jury secrecy provisions of Rule 6(e) of the Federal Rules of Criminal Procedure.

In these ways, DOJ, LMSA, and OOCR facilitate the effective enforcement of the criminal provisions of LMRDA, ERISA, and related Title 18 offenses.

LMSA alone currently investigates alleged civil violations of both LMRDA and ERISA. These investigations are conducted by LMSA field offices, which are organized into separate investigative "tracks" to ensure that investigators with specialized expertise will be responsible for investigations under each act.

As soon as the office of Pension and Welfare Benefit Programs (PWBP), which is currently part of LMSA, completes the transition to an independent office reporting directly to the Secretary, it will assume the responsibilities under ERISA that are currently discharged by LMSA. In this way, the Department expects that its LMRDA and ERISA enforcement programs will be more directed, vigorous, and effective.

4. Two years ago, during hearings that I conducted on the Office of Federal Contract Compliance Programs, it became evidenct that in the past the federal government had used two different standards when investigating employment discrimination. The EEOC was bound by the procedural and substantive limitations Congress placed in Title VII of the Civil Rights Act of 1964. OFCCP, on the other hand, was not so bound. Would you please explain the Department's current position as to whether OFCCP is bound by Title VII when determining if an allegation of past employment discrimination is actionable.

ANSWER:

The Department of Labor, in enforcing Executive Order 11246, follows the limitations set out in Title VII. Thus, as to recovery of back pay, for example, we recognize the two-year limitation imposed by the Act.

On the issue of whether an incident of alleged discrimination is actionable, we take the following positions:

(a) OFCCP's regulations require that individual complainants file their complaints with OFCCP within 180 days of the alleged act of discrimination. See 41 CFR § 60-1.2. This is consistent with the Title VII restrictions imposed on EEOC. Indeed, pursuant to a Memorandum of Understanding between the Department of Labor and EEOC, we refer such individual complaints to EEOC. The fact that both agencies recognize the same 180-day limitations period prevents forum shopping.

(b) As to evidence that is uncovered as a result of an OFCCP compliance review, we consider actionable any incident of discrimination occurring up to two years prior to notice of a desk audit. Consistent with case law under Title VII, we also recognize a "continuing violation" theory. Thus, violations that began more than two years prior to notice of desk audit are actionable if they continued beyond that period. In addition, evidence of discrimination that is not itself actionable because it occurred before the relevant time period may still be used as historical evidence, to show a pattern of discriminatory conduct.

Answers to Questions Submitted by Senator Quayle

1. As you interpret the meaning and intent of the Job Training Partnership Act, what do you look to as the legislative history of the Act? That is, what are your documented sources?

ANSWER:

When we interpret a statute, especially a newly enacted statute such as JTPA, we take into consideration all of the traditional items which comprise the history of the statute. This would include, where available, such facts or events as the preenactment history, reports of committees, legislative debates, bills as submitted, and the legislative action on proposed amendments to a bill.

In the case of JTPA, in addition to considering the plain meaning of Public Law 97-300 (JTPA), we particularly take into consideration S. 2036, H.R. 5320, H. Rept. No. 97-537, Senate Report 97-469, the Conference Report (H. Rept. No. 97-889), Senate Concurrent Resolution 127, and the various remarks which were made from the floor during the JTPA legislative process.

2. Does Section 4(16) of the Act require the Labor Department to issue an annual adjustment in the lower living standard income level?

ANSWER:

Section 4(16) of the Job Training Partnership Act (JTPA) requires the Secretary of Labor to determine annually the lower level standard income level based on the most recent lower family budget, formerly produced by the Bureau of Labor Statistics (BLS). The FY 1982 Appropriation Act eliminated the family budget program from the BLS budget. To comply with the requirements of JTPA, the Secretary will determine the LLSIL by using the Consumer Price Index to update the lower family budget.

3. Under Section 164(e), "recipients" are relieved from liability when they comply with specified conditions. Please analyze the legislative history to determine whether the statutory term was intended to be limited to "direct" recipients of funds from the Secretary.

ANSWER:

It is clear to the Department that, in the context of Section 164(e) of the statute, there is little forgiveness provided for the person or organization that actually misspent the funds. The statute is also clear that the entities such as the States which receive funds directly from the Department of Labor are to be tested according to their administration and oversight of JTPA funds. The Department's pursuit of misexpenditures will flow first to the Governor, as State recipient, and then, through the State, to the Service Delivery Area (SDA) and other subrecipients. Sanctions need not be imposed against a grantee where the misexpenditure was by a subgrantee if the direct grantee was not at fault and met the criteria at Section 164(e)(2) for attempting to effect compliance with the Act. The legislative history of

JTPA also makes it clear that these criteria also apply to subrecipients. Thus, the Department's regulations permit Governors to request the Secretary's prior approval of corrective action where a subrecipient meets these criteria.

4. JTPA requires that recipients of Aid to Families with Dependent Children, Title IV of the Social Security Act, and high school dropouts be served "on an equitable basis" (Section 203(a)(3)). What are the Department of Labor's legal remedies in regard to enforcement of this requirement?

ANSWER:

AFDC recipients are generally eligible to be participants under JTPA programs. In addition, Section 203(b)(3) of the Act requires that under the JTPA Title II Programs such AFDC recipients "shall be served on an equitable basis, taking into account their proportion of economically disadvantaged persons sixteen years of age or over in the area."

Under the Act and regulations, the uses of JTPA funds are determined and set forth in the Job Training Plan at the Service Delivery Area (SDA) level by the chief elected officer and the SDA Private Industry Council (cf. Section 104). Pursuant to Section 105 of the Act, the Governor is responsible for reviewing the plan and shall approve it except in five general circumstances, including where the plan fails to ". . .comply with a particular provision or provisions of this Act or of the regulations of the Secretary under this Act." Section 105(b)(3) of the Act also provides interested parties with the right to appeal to the Governor to disapprove a plan where they believe it fails to conform to the requirements of the Act.

Section 164(e) of the Act makes it clear that both recipients and subrecipients are liable for misexpenditures, and provides enforcement schemes as to each. Thus, Section 164(e)(3) provides:

> If the Secretary determines that the recipient has demonstrated substantial compliance with the requirements of paragraph (2), the Secretary may waive the imposition of sanctions authorized by this section upon such recipient. The Secretary is authorized to impose any sanction consistent with the provisions of this Act and any applicable Federal or State law directly against any subgrantee for violation of this Act or the regulations under this Act.

Under the Department's implementing regulations, the Secretary, as a result of audits or evaluations, may direct the Governor to handle a complaint through local grievance procedures, or may investigate and determine whether the Governor or subrecipients are in compliance. See 20 CFR §629.54(b). While the emphasis in the Department's regulations is on effecting compliance through the recipient, the regulations also state:

> Nothing in this section shall preclude the Secretary from issuing an initial and final determination directly to a subrecipient in accordance with the authority of Section 164(e)(3) of the Act.

20 CFR §629.54(e).

Section 164 of the Act sets forth the sanctions available to the Secretary, and the Department's regulations specify that the Secretary may impose sanctions directly against a subrecipient, so long as the Secretary informs the Governor of his actions. 20 CFR §629.44(f). Thus, for example, the Secretary may recover misexpended funds from a subrecipient, and this sanction may be effectuated by the various means set forth in 20 CFR §629.44.

The particular sanction that will be imposed against a recipient or subrecipient, of course, depends on the circumstances. While Section 164 of the Act and 20 CFR §629.44 provide for certain sanctions, it is clear that the enumerated remedies "shall not be construed to be exclusive remedies" (Section 164(h) of the Act).

5. Under Section 302(d), the Act requires that participation in a Title III program must be deemed "to be acceptance of training with the approval of the State within the meaning of any other provision of Federal law relating to unemployment benefits." Section 3304(a)(8) of the Internal Revenue Code requires that as a condition for a State to participate under the Federal Unemployment Tax Act, the State's laws must not deny compensation benefits to individuals who are participating in State approved training. What are the Labor Department's legal remedies in enforcing these provisions in States which deny individuals Unemployment Insurance compensation because they are participating in a Dislocated Worker program, under Title III?

ANSWER:

Section 302(d) of JTPA requires training under Title III to be treated as approved training within the meaning of any other federal law relating to unemployment benefits. The only other federal law relating to training and eligibility for unemployment benefits is Section 3304(a)(8) of the Federal Unemployment Tax Act, which requires state unemployment compensation laws to provide that benefits shall not be denied to individuals in training approved by the state agency. Enforcement of individual rights of Title III trainees would therefore come under state law provisions corresponding to Section 3304(a)(8), as such provisions may have to be modified to include Title III trainees. Enforcement of the requirements of Section 3304(a)(8), as modified by Section 302(d) of JTPA, would be handled under the provisions of the Federal Unemployment Tax Act as other conformity and compliance matters are handled. If discussion and negotiation fail to result in a resolution of question, the Secretary has available the remedy of conformity and compliance proceedings under Section 3304(c) of the Federal Unemployment Tax Act. See Unemployment Insurance Program Letter No. 32-83 (copy attached) on this subject.

U.S. DEPARTMENT OF LABOR
Employment and Training Administration
Washington, D.C. 20213

CLASSIFICATION
UIS
CORRESPONDENCE SYMBOL
TEURL
DATE
June 29, 1983

DIRECTIVE : UNEMPLOYMENT INSURANCE PROGRAM LETTER NO. 32-83

TO : ALL EMPLOYMENT SECURITY AGENCIES

Royal Dellinger

FROM : ROYAL DELLINGER
Administrator for
Regional Management

SUBJECT : Acceptance of Training Opportunities under Job Training Partnership Act (JTPA)

1. Purpose. To inform SESAs that acceptance of training opportunities by eligible individuals pursuant to Section 302, JTPA, will be deemed acceptance of such training within the meaning of requirements in Section 3304(a)(8), FUTA.

2. References. Section 302, JTPA; and Section 3304(a)(8), FUTA.

3. Background. Paragraph (8) was added to Section 3304(a), FUTA, in 1970 requiring, as a condition for State certification under Section 3304(c), FUTA, that benefits shall not be denied to an otherwise eligible individual for any week during attendance of training with the State agency's approval. That means that an individual taking such training may not be found ineligible for benefits on grounds that he/she is not available for suitable work, is not making an active search for work, or has refused suitable work. A State must consider a trainee in an approved training course entitled to benefits if otherwise eligible, and it is prohibited from denying benefits thereafter for the causes specified above.

Ordinarily, a State has discretion to determine what training is appropriate for a claimant for benefits, to establish the criteria for approval of a training course, and to adopt safeguards to assure that the claimant is actually attending approved training. Section 302, JTPA, however, preempts State agency discretion to approve training under specified conditions.

RESCISSIONS	EXPIRATION DATE
	June 30, 1984

DISTRIBUTION

Under Section 302, a State "is authorized to establish procedures to identify substantial groups of eligible individuals who" have been terminated or received a notice of termination or layoff from employment; "are eligible for or have exhausted their entitlement to unemployment compensation, and are unlikely to return to their previous industry or occupation"; or are long-term unemployed with limited opportunities for work in the same or similar occupations where they reside. The State then "shall determine" what job opportunities exist for which such individuals can be retrained and "whether training opportunities for such employment opportunities exist or can be provided within the local labor market area." When such training opportunities are so identified, information about such opportunities "shall be made available to the individuals." Under subsection (d) --

> "The acceptance of training for such opportunities shall be deemed to be acceptance of training with the approval of the State within the meaning of any other provision of Federal law relating to unemployment benefits."

4. Interpretation. Such "other provision of Federal law" is interpreted to include Section 3304(a)(8), FUTA, as described above. All State laws contain, or should contain, provisions that parallel requirements of Section 3304(a)(8). A State agency is prohibited, as a condition of a State's certification under Section 3304(c), FUTA, from denying benefits to an individual who:

a. is one of a substantial group of eligible individuals who has been terminated or received notice of termination from their jobs;

b. is one of a group which is eligible for unemployment benefits or has exhausted entitlement thereto; and

c. either, (1) is unlikely to return to the previous industry or occupation, or (2) is long-term unemployed with limited opportunities for work in the same or similar occupations in the area where he/she resides; and

d. has accepted a training opportunity for which information was made available by the State to such group of individuals.

5. Action Required. Administrators are requested to review their laws to ensure that there is no obstacle to requiring acceptance of JTPA as approved training and to establish procedures for coordinating their activities with those of other State agencies or officials administering programs and training under JTPA in fulfillment of the requirements described above.

States that can not interpret their laws to implement this requirement should notify their regional office as to what corrective action will be undertaken to comply with the new requirement.

6. Inquiries. Direct questions to the appropriate regional office.

U.S. Department of Labor

Office of the Solicitor
Washington, D.C. 20210

FEB 16 1984

Honorable Howard M. Metzenbaum
Committee on Labor and Human Resources
United States Senate
Washington, D.C. 20510

Dear Senator Metzenbaum:

Enclosed please find my responses to the questions you posed to me by letter of February 9, 1984, as part of the hearing on my nomination for the position of Solicitor of Labor.

Sincerely,

Francis X. Lilly

Francis X. Lilly
Deputy Solicitor of Labor

Enclosures

Question:

(1) If you are confirmed to be the Solicitor of the Department of Labor,you will be actively involved in developing departmental policy on plan terminations. I would like to know your:

A. Personal philosophy on this issue;

B. Your interpretation of what the law is in this area; and

C. Whether you think the current policy, as established by the Employee Retirement Income Security Act (ERISA) should be changed, and if so how?

Answer:

(A) My personal view is that if policy changes can be developed which provide additional protections to plan participants and beneficiaries without undermining the existing pension system which is totally voluntary, I would favor such changes.

(B) Under current law, plan sponsors may freely terminate plans and recover assets which remain after satisfaction of the plan's liabilities in accordance with §4044 of ERISA.

(C) I think that any changes in policy should be made only after full consideration of their impact on the pension policy established by Congress in ERISA, of which the voluntary nature of plan establishment and termination is an integral part. We are in the process of examining whether those changes need to be made.

Question

(2) Please describe any abuses which you believe exist with respect to the terminations of overfunded pension plans.

Answer

Since I believe that the voluntary pension system serves a very important purpose for workers and for the country, I do not favor policies which encourage termination for any reason. I cannot speak to possible tax abuses and do not believe that termination of an overfunded plan itself poses any danger to the insurance system administered by the PBGC. Current law provides that the decision to terminate a plan is not governed by the fiduciary provisions of Title I of ERISA which the Department of Labor administers but that there may be fiduciary decisions made in implementing a termination. We would pursue any abuses in the latter area on the same basis as other fiduciary violations.

Question

(3) What statutory authority does the Department of Labor have in current law to protect employees and retirees when an employer seeks to terminate an overfunded pension plan? Do you feel this authority is adequate to fully protect pension plan participant? If not, what specific changes would you propose?

Answer

The Department of Labor has no formal role in the termination process. The Department has taken the position that the employer's decision to terminate a pension plan is a business decision not governed by the fiduciary provisions of Title I of ERISA which the Department administers. That policy was recently upheld by the United States district judge ruling on the private suits relating to the Harper and Row termination, District 65, UAW, et al. v. Harper & Row Publishers, Inc., et al. (S.D. N.Y. 1984). The participants' rights to benefits are under current law protected through the termination requirements of Title IV of ERISA which is administered by the PBGC. However, the Department has asserted and believes it has the authority to ensure that the fiduciaries carry out their responsibilities with regard to the distribution of assets following the sponsor's decision to terminate. We are currently considering whether changes in current law should be proposed.

Question

(4) Please provide copies of any materials concerning plan terminations, either prepared by you or reviewed by you, for purposes of advising Secretary Donovan in his role both as Secretary of Labor and as a member of the Board of Directors of the Pension Benefit Guaranty Corporation?

Answer

Attached is a copy of a memorandum dated February 10, 1984, to the Secretary as Chairman of the DOL Working Group established by the Secretary in November 1983. It discusses the general issue of plan terminations and asset reversions. Also attached is a copy of a memorandum, prepared at my direction, which the Secretary sent to other members of the Board of Directors. The latter document transmitted to the other PBGC Board members a copy of a paper (also attached) prepared by the PBGC staff focusing on the effect of plan terminations on the insurance system administered by the PBGC.

Question

(5) A number of companies have used their pension assets to finance acquisitions or to fend off takeover bids. This was the case in both Harper & Row and Occidental Petroleum. Do you have any concerns about the use of pension plan assets for such purposes? If you believe pension plan assets should be neutral in takeover situations, have you recommended any legislative or regulatory changes which would assure the neutral status of plan assets? If not, why? Has the Department articulated any policy which would discourage the use of pension plan assets as a tool in acquisitions or takeover bids?

Answer

The Department has taken a number of actions designed to discourage the abuse of plan assets in takeovers, acquisitions and other activities where the plan sponsor's interests are involved. In October 1981, the Department filed what has become the leading case relating to plan involvement in takeovers, Donovan v. Bierwirth. In that case, the Department prevailed on a motion for preliminary injunction which was upheld by the U. S. Court of Appeals for the 2d Circuit. The case is presently awaiting a final decision. In Bierwirth, we alleged that the trustees of the Grumman Corporation pension plan violated their fiduciary duties by purchasing a large block of Grumman stock in order to help defeat a hostile attempt to acquire Grumman. In May 1983, the Department filed Donovan v. Simmons, alleging that a number of pension plan fiduciaries violated their statutory duties by using plan assets to further their own attempts to acquire other companies. After prevailing on a motion for preliminary injunction, the Department reached a settlement with the defendants which provided for broad prospective relief without prejudice to the rights of private plaintiffs to continue to seek additional remedies. Other activities in this area have included representing the Secretary as *amicus curiae* in *Leigh* v. *Engle*, a case which has resulted in a broad favorable precedent on the scope of fiduciary duties. Besides this involvement in actual litigation, the Department has carefully studied the takeover area and taken a number of other steps including the announcement of certain policy positions and the establishment of a mechanism for coordinating possible enforcement action with the Securities and Exchange Commission. In short, the Department has taken an active role in attempting to assure that plan assets are not abused in favor of sponsor interests. This is to be distinguished, however, from situations where a plan has been terminated pursuant to Title IV and some of its assets thereafter revert to the sponsor which may lawfully use the assets for its own purposes just as if the sponsor had never initially established the plan.

Question

(6) What activities have been undertaken by the Department of Labor to develop policy on the issue of plan terminations. Please provide a list of meeting dates, individuals who attended, agendas, and briefing materials used for such meetings. What suggestions were made by you at those meetings concerning the Department's policy?

Answer

The Department is in the process of developing policy positions which approach the termination issue not from any single perspective such as tax policy or termination insurance but in light of the overall policy established by Congress in ERISA to encourage and maintain a voluntary pension system which delivers promised benefits to plan participants and beneficiaries. To that end, the Secretary, as discussed above, has established an internal working group which is in the process of developing policy options and recommendations based on our own legal and economic analysis of the termination issue. There have been numerous informal discussions within the Department on this issue. The meetings of which I have knowledge and their attendees are listed below; there were no printed agendas or briefing materials although some of the documents described in response to questions 4 and 8 were subjects of discussion at some of these meetings. My personal suggestions were that the Department proceed as described earlier in this paragraph and that the Department's position be carefully coordinated with other affected agencies before any changes are proposed in the overall pension policy established by Congress as reflected in ERISA.

DATE	SUBJECT	PARTICIPANTS
9/13/83	ERISA Advisory Council consideration of termination issue	Attendees were numerous; speakers on this issue included Clayton, Thomas, Gordon, Woodruff
9/23/83	Plan Terminations/ Asset Reversions	Secretary Donovan, Cowan, Lilly, Benjamin, Walsh, O'Donnell, Lebowitz, Sirkin
11/16/83	Working Group on Plan Terminations/Asset Reversions	Lilly, Townsend, St. Cyr, Williamson, Walsh, Sirkin, Eccles, Kramer
12/5/83	Plan Terminations/ Asset Reversions	Secretary Donovan, Cowan, Lilly, Lebowitz
12/6/83	Working Group	Lilly, Townsend, Walsh, St. Cyr, Kramer, Eccles, O'Donnell, Lewis, Lebowitz, Sirkin, Myers
12/8/83	Plan Terminations/ Asset Reversions	Lilly, Lebowitz, Eccles, Sirkin
12/14/83	" "	Lilly, Lebowitz, Eccles
12/21/83	" "	Lebowitz, Eccles, Myers, Sirkin
1/6/84	" "	Lilly, Monks, Lebowitz, Eccles
1/18/84	" "	Lilly, Monks, Lebowitz
2/8/84	" "	Monks, Lebowitz, Benjamin, Ippolito, Sirkin, Kramer, Hankin, Lewis, Myers

Question

(7) Please provide copies of all communications between the Department of Labor and companies which have requested approval of termination of their overfunded pension plans since 1981. Please provide the dates of meetings held, the agendas, and personnel involved in meetings with companies on the issue described above.

Answer

The Department of Labor does not have any role in approving plan terminations and thus there are no communications relating to such approval. As part of its interest in pension policy in general, Department of Labor personnel have on occasion met with representatives of companies which were in the process of terminating plans. I have attached a list of those meetings and their participants as well as a list (and copies) of correspondence from attorneys whom, I understand, represent such companies. This list does not include Department of Labor contacts directly related to investigative or enforcement activities (such as the investigation relating to Harper & Row).

Meetings

DATE	SUBJECT	PARTICIPANTS
12/20/83	Celanese Corporation briefing re Plan Termination/Asset Reversions	Celanese Corp. (Olgive, Payne, Irish) Arthur, Clayton, Eastburn, Jones, Kelly, Lebowitz, Lilly, Mayer, Niskanen, Utgoff, Shorin (A copy of a briefing paper distributed at that meeting is attached)
1/25/84	Terminations, reversions	Monks, Lebowitz, Klevan, Sirkin, Steven Sacher, Leon Irish, Gary Quintiere, Randolf Hardock

Correspondence

DATE	SUBJECT
12/20/83	Letter to Assistant Treasury Secretary Chapoton from attorney group re Pension Plan Terminations and Employer Reversions
12/23/83	Copy of letter from William Kravitz, Esq. to Internal Revenue Service

Question

(8) Please provide the dates of meetings held between the Department of Labor and the Internal Revenue Service, the Department of Treasury, or the Pension Benefit Guaranty Corporation concerning the plan termination issue. Please include the agendas, participants, and a description of the suggestions made by you in those meetings. In addition, please provide copies of all correspondence between the Department of Labor and the Internal Revenue Service, the Department of Treasury, and the Pension Benefit Guaranty Corporation concerning the pension termination issue.

Answer

I believe that the list below is the most complete which the Department of Labor personnel can compile. At those meetings which I attended, I suggested that any changes to the pension system which Congress established in ERISA should be made, if at all, only after full examination of the facts of plan terminations and should not be based solely on any one agency's perspective but should reflect a coordinated agency approach to national pension policy. The appropriate files are being reviewed to collect the correspondence you have requested.

DATE	SUBJECT	PARTICIPANTS
1/31/83	Western Airlines plan termination	Clayton, Lebowitz, Winborne, Jones (PBGC)
1/31/83	Plan terminations/ Asset Reversions	Clayton, Winborne, Jones Cohen (IRS)
7/5/83	ERISA Policy Board	These three meetings involved numerous participants from PBGC, IRS, Treasury. DOL participants were Clayton, Lebowitz and other staff from PWBP or the Solicitor's Office.
7/6/84	" "	
7/13/84	" "	
12/8/83	ERISA Policy Board	Meeting with PBGC, IRS, Treasury; DOL representatives were Lebowitz, Sirkin, Eccles, Myers
12/13/83	Plan Terminations/ Asset Reversion	Barry Conaway (Treasury) Lebowitz, Sirkin, Myers, Upgoff (CEA)
12/14/83	" "	PBGC, IRS and Treasury officials, Lilly, Lebowitz, Eccles
1/4/84	PBGC Board Meeting re Terminations/Asset Reversions	Jones, Walker, Rose, Aubry, Lilly, Kramer
1/25/84	Terminations, reversions, excess assets	Monks, Lebowitz, Lilly, Aubry, PBGC, IRS, Treasury

Question

(9) The Internal Revenue Service, in its testimony before the Houe Select Committee on Aging, indicated that it was aware of "abuse situations" in which an employer terminates a plan, simultaneously establishes a new plan for active employees but not retirees, and recaptures funds from the terminated plans. These schemes are referred to as "spinoffs." Within the last several weeks, the Pension Benefit Guaranty Corporation, has given tentative approval to the Amax Corporation, which uses the same scheme described above, to terminate its pension plan. Given that the PBGC is proposing to use the Amax termination as a prototype, have you seen any need for the Department of Labor to intervene to assure that this "model" protects the needs of workers? Has the Department of Labor played any role in the Amax negotiations? Have you personally made any suggestions with respect to Amax? Please share your personal opinion regarding the PBGC notice of sufficiency and the general issues raised by the Amax case.

Answer

The Department of Labor did not play any direct role in the Amax negotiations. As Deputy Solicitor of Labor, I do not think it would be appropriate for me to comment on PBGC's Notice of Sufficiency. Department representatives were advised of the proposed agreement between the PBGC and Amax, and the generic problem of "spinoff" terminations was discussed among Department of Labor and PBGC, IRS and Department of Treasury representatives on several occasions. Within the boundaries of current law, the agreement reached as to the Amax termination provided additional protections to both workers and PBGC. Whether this type of arrangement should serve as a "model" for future terminations and, if so, whether this can be accomplished under current law, are among the topics under active consideration within the Department and among the affected agencies.

Question

(10) Are you aware that, in response to its concerns that spinoff terminations constituted serious abuses, the Internal Revenue Service reached a decision on regulations and changes in policy, that it felt would be necessary to prevent the abusive recovery of excess assets, and was prepared to publicly announce the appropriate actions? What role was played by the Department of Labor in the IRS failure to announce the policy change? Were you in any way personally involved in the subsequent decision by the Internal Revenue Service not to announce the change in policy? If you were aware of the recommendations made by the IRS, did you believe their analysis was correct and their recommendations appropriate?

Answer

I am aware that the IRS arrived at certain preliminary positions regarding possible approaches to dealing with what it viewed as adverse tax consequences in the termination area. I am not aware of the IRS analysis of the tax consequences and, because I do not specialize in tax matters, I am not familiar with the technical analysis of the provisions of the Internal Revenue Code. The Department of Labor expressed the view to the IRS that changes in tax policy which clearly implicate significant aspects of pension policy should not be viewed in isolation as merely tax issues but should be coordinated with overall pension policy. That coordination process is underway, and I believe that it is the best way to proceed to arrive at a coherent policy.

Question

(11) As you may be aware, the House Select Committee on Aging has been holding hearings on the issue of terminations of overfunded pension plans. Chairman Roybal, of that committee, has raised concerns about conflicts in the Department's testimony with respect to the Department's policy on plan terminations. In a letter to Secretary Donovan, Congressman Roybal expressed specific concerns about statements made by Mr. Charles Williamson, Assistant Administrator for Enforcement, Pension and Welfare Benefit Programs. Mr. Williamson stated that in Harper and Row, "there might have been a scheme to manipulate plan assets for purposes that were not solely in the interest of plan participants." It is my understanding that Mr. Williamson requested from the Solicitor's office and analysis and opinion with respect to the best legal argument for a departmental finding that the Harper and Row termination violated fiduciary standards of the Employee Retirement Income Security Act (ERISA). In light of the concerns expressed by Mr. Williamson, why did the Solicitor's office choose not to take any action in the Harper and Row case?

Answer

Under the Department's procedures, the Solicitor's Office prepares a legal analysis which is provided to the program agency which, assuming a legal basis exists, makes a final decision on whether enforcement action should be brought. The legal analysis of the Harper and Row matter is contained in a memorandum prepared by the Plan Benefits Security Division of the Solicitor's Office which, I understand, has been provided to your staff. One principal legal conclusion reached in that analysis is that decisions to establish or terminate plans are not subject to challenge under ERISA's fiduciary provisions. As you may be aware, the same conclusion has been reached by the United States district judge before whom private suits arising from the Harper and Row termination are pending. The relevant officials in the pension program concurred in our staff's legal analysis and decided to take no enforcement action.

Question

(12) Recently, the House Subcommittee on Labor-Management Relations of the House Education and Labor Committee held oversight hearings on the Department of Labor's enforcement of the employer and consultant reporting provisions of the Landrum-Griffin Act. That Subcommittee has issued a report stating that the Department of Labor has enforced the Landrum-Griffin Act in a lopsided manner, resulting in employers being allowed to ignore the disclosure requirements, while unions have been required to comply fully. With respect to the report, I would like to know the following:

A. Your assessment of the Subcommittee report, that is whether you believe the report is accurate. If you do not believe it is accurate, why?;

B. What cases, if any, are currently pending with the Department of Labor in this area, and your personal views on each;

C. Whether or not you believe it was appropriate for the Department of Labor to discontinue all cases involving "indirect" theories concerning consultants and to do so without benefit of public notice;

D. Whether you believe that there have been effective steps taken by the Department of Labor to assure equal treatment of both unions and employer labor consultants;

E. What role you have played in the Department's policy on the enforcement of the Landrum-Griffin Act;

F. Whether, from your examination of the issue, the provisions of the law have been fairly and equally implemented.

Answer

A. I have reviewed the report that was prepared by the majority staff of the House Labor-Management Relations Subcommittee of the House Education and Labor Committee before the recent oversight hearings on the enforcement of the employer and consultant reporting provisions of the

Labor-Management Reporting and Disclosure Act (LMRDA). I am not aware that the report has been endorsed by the Subcommittee itself. The facts and figures upon which the report is based appear to be accurate, with minor exceptions. For example, I have been informed that the report is in error in stating that 70,000 unions file detailed reports; 70,000 reports are, in fact, filed by approximately 50,000 unions. Moreover, I do not believe it is accurate to state that "the current Administration has substantially undermined effective implementation of this law." Indeed, as indicated in Secretary Donovan's February 3, 1984, response to Congressman Clay's inquiry of September 8, 1983 (p. 4), twelve civil actions have been filed to obtain reports required by section 203 of the LMRDA during the last three years. This volume of litigation surpasses the number of cases filed during any similar period since the passage of the Act, with the exception of a two-year period (1962-1964), just after passage of the LMRDA, when eleven cases were filed.

It also should be noted that the report gives a misleading impression on the level of actionable complaints that had been received historically. Although the Department does not maintain records on the precise number of complaints received, our experience has shown that prior to 1980, an average of about 30 to 40 complaints were filed each year. Then in 1980, primarily due to a major effort by organized labor, the level of complaints abruptly rose. In large part because of this increased activity, the Department opened over 400 cases in 1980.

B. The Department of Labor is currently litigating the following cases in order to obtain reports from employers and consultants:

Marshall v. South Hills Health System

(Filed 1/14/81; W.D. Pa.)

Donovan v. Anja Engineering Co.

(Filed 8/21/82; C.D. Calif.)

Donovan v. West Coast Detective Agency

(Filed 4/21/82; C.D. Calif.)

Donovan v. Richard S. Buse

(Filed 3/4/83; M.D. N.C.)

Donovan v. M.K. Sullivan, Mike Sullivan Associates, Inc.

(Filed 9/8/83; E.D. Ark.)

The foregoing cases are described in Secretary Donovan's February response to Congressman Clay's inquiry of September 8, 1983 (pp. 5-6). In addition, the Department is currently defending the following suits in this area:

Master Printers v. Donovan (4th Cir.)

Master Printers Association v. Donovan (7th Cir.)

Humphrey, Hutcheson & Moseley v. Donovan (6th Cir.)

International Union, UAW, et al. v. Donovan (D.C. Cir.)

United Food and Commercial Workers Union, Local No. 126 v. Donovan (N.D. Calif.)

Litigation is being considered in several other cases.

The same procedure is followed in every case in which the Secretary files a civil action to compel compliance with the employer and labor consultant reporting provisions of the LMRDA. When the Office of Labor-Management Standards Enforcement (LMSE) concludes, following an investigation, that reports are required, it attempts to secure voluntary compliance with the Act by informing the employer or consultant in question of the obligation to file. LMSE may or may not seek legal advice from the Solicitor's Office with respect to a particular case at this stage. If the reports are not provided voluntarily, LMSE refers cases involving employers or consultants to the Labor-Management Laws Division (LML) of the Solicitor's Office. After LML has reviewed the investigative file and the legal theory involved and is satisfied with respect to the legal sufficiency of the case. That Divion refers the case with a legal analysis to the immediate office of the Solicitor where the Deputy Solicitor or Solicitor determines whether to authorize the filing of a complaint. If the Solicitor agrees that the action should be brought, the case is referred to the Department of Justice for litigation. The U.S. Attorney then files a complaint in the appropriate U.S. district court. Thereafter, the litigation of the case may be handled either by the U.S. Attorney's office or by a Regional Office of the Solicitor of Labor. Legal assistance is provided in either case by the LML Division of the Solicitor's Office here in Washington. Thus, in my capacity as Deputy Solicitor, I am involved not only in the decision to litigate but also as an advocate for the Secretary's position in such suits. Accordingly, it would be inappropriate to express personal views with respect to any of these cases.

C. Cases where there is no evidence of direct contact between the consultant and the employees typically involve activities which fall within the category of "advice" and are, therefore, explicitly exempt from the reporting requirements under section 203(c) of the Act. In Kawasaki, supra, (slip opinion at 15), the U.S. District Court for the District of Columbia found that the Secretary's refusal to bring an enforcement action with respect to such activities was "both rational and defensible." As Judge Greene noted in that case (sl. op. at 13), "agencies engaged in prosecutorial and enforcement activities need considerable latitude because of their limited resources and their need to establish priorities." I agree with Judge Greene that there is no indication that the Department's broad prosecutorial discretion has been abused and I do not believe that any public notice is required when such discretionary determinations are made.

D. The LMRDA contains various obligations, prohibitions and reporting requirements in seven separate titles. However, only Section 203 of Title II imposes any direct obligation on employers and consultants. Nor does the Act proscribe any significant employer activity, except insofar as it amends section 302 of the Labor-Management Relations Act of 1947. Thus, it would appear that Congress did not intend to impose the same sort of reporting burdens on employers or consultants as on unions under the LMRDA.

Section 201 of Title II requires every labor organization to adopt a constitution and bylaws and to file them with the Secretary along with several detailed reports; section 202 of the same Title requires every union officer and employee to file a detailed report each year; Title III imposes reporting obligations, as well as other obligations with respect to a labor organization that has or assumes trusteeship over a subordinate body. In addition, Titles I, IV, and V provide stringent requirements which must be met by labor organizations and officials with respect to the rights of individual members, the conduct of union elections and the financial affairs of labor organizations.

Employers and consultants, on the other hand, are required to file reports only when they engage in certain specified conduct. Moreover, their obligation to report is qualified by broad Congressionally-mandated and judicially enforced exemptions for "advice" and for payments to supervisors for their regular services; the information they are required to report is far less detailed than that required of unions. Although the application of the exemptions makes the enforcement of these provisions more complex than the routine issues arising under union reporting provisions, the Department of Labor has successfully litigated several cases to require employers and consultants to file reports in appropriate circumstances. Therefore, I believe the Department of Labor has taken effective steps to enforce the statute.

E. The Deputy Solicitor's role is limited to reviewing the legal sufficiency of the cases and determining whether to authorize the filing of a complaint (See Answer to 12.B, supra). In my view, it is appropriate for the agency entrusted with the interpretation and enforcement of a particular statute to decide all policy issues, including questions regarding the appropriate allocation of agency resources among the programs it administers.

F. As noted above, the provisions of the LMRDA impose far greater burdens on labor organizations both with respect to the number of reports which must be filed and the kind of information which must be reported, as well as in requiring compliance with numerous restrictions regarding the conduct of union affairs. Therefore, it appears that Congress never intended that the provisions be "equally implemented" in the sense that resources should be equally allocated between the provisions applicable to unions and those applicable to employers and consultants. However, my review of the Department's allocation and efforts also indicates that the Department's efforts under Secretary Donovan have been good faith efforts to obtain the best possible results for the employees whose rights are protected by the LMRDA. These efforts have been directed toward protecting the working men and women of America who belong to the covered labor organization as well as those whom the LMRDA attempts to ensure will be aware of any attempt by management to influence their decision to organize or not.

Question

(13) Have you discussed any cases involving the Landrum-Griffin Act, pending before the Department of Labor, with Mr. Timothy Ryan, the former Solicitor of Labor? Please provide copies of all communications and descriptions of all other discussions you have held with Mr. Ryan regarding these cases.

Answer

During the time period T. Timothy Ryan was Solicitor of Labor, I met with him on a regular basis, generally several times during the course of a workday, to discuss a variety of matters pending in the Solicitor's office. On occasion, these discussions included pending election and trusteeship cases involving Titles III and IV of the Landrum-Griffin Act. However, since Mr. Ryan recused himself from the outset of his duties from employer-labor consultant reporting cases under Title II of the Act, I never discussed any such cases with him.

U.S. Department of Labor

Office of the Solicitor
Washington, D.C. 20210

FEB 29 1984

Honorable Howard Metzenbaum
Committee on Labor and Human Resources
United States Senate
Washington, D.C. 20510

Dear Senator Metzenbaum:

Enclosed pursuant to your request in question No. 8 of those propounded to me are copies of documents and correspondence between the Department of Labor and the I.R.S., the Department of Treasury and PBGC concerning the pension termination issue.

Very truly yours,

Francis X. Lilly

Francis X. Lilly
Deputy Solicitor of Labor

Enclosures

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

EIN/PN:
In reply refer to:
Name of Plan:

The Pension Benefit Guaranty Corporation (PBGC) received the information required to demonstrate sufficiency relating to the termination of the above-identified Plan. Based on this, the Corporation is issuing the enclosed Notice of Sufficiency in accordance with Section 4041(b) of the Employee Retirement Income Security Act of 1974 (ERISA).

Upon receipt of the Notice of Sufficiency, you have 90 days to complete the termination of the Plan in accordance with Subtitle C, Title IV of ERISA. As of the date of plan termination, the plan provides for reversion to the employer of any assets remaining after all plan benefits have been provided. PBGC expresses no opinion as to whether this provision is legally valid. However, if the plan is contributory, the portion of residual assets attributable to employee contributions must be allocated to eligible participants as provided in PBGC's regulation on Allocation of Assets.

Please note that in order to remove your plan from the PBGC-1 Form and premium billing mailing list, Subpart C of 29 CFR Part 2617, requires you to submit to PBGC within 60 days after the completion of the distribution of plan assets, a certified statement that the plan assets were allocated in accordance with Section 4044 of ERISA, and also include the following information:

(1) For each participant or beneficiary to whom distribution was made--
  (a) Name;
  (b) Address;
  (c) Telephone number;
  (d) Sex;
  (e) Date of birth;
  (f) Social security number;
  (g) The amount of benefit provided and unless previously submitted, the basis for computing the amount;
  (h) The cost of providing the benefit; and
  (i) The form in which the benefit was provided.

(2) If annuity contracts were purchased from an insurer, the name of the insurer and the policy number(s); and

(3) The place or places where plan records will be held.

Sincerely,

Case Officer
Case Processing Division,
(202)

Enclosure

Pension Benefit Guaranty Corporation
2020 K Street N.W. Washington D.C. 20006

NOTICE OF SUFFICIENCY

Name of Plan: Wildasin Motors, Inc. Defined Benefit Pension Plan & Trust

Date of Termination: October 1, 1977

Pursuant to the authority vested in it by the Employee Retirement Income Security Act of 1974, Section 4041(b), 88 STAT 1020, 29 U.S.C. 1341(b), and based upon information supplied to it, the Pension Benefit Guaranty Corporation hereby finds that the assets of the above-identified Plan were sufficient as of the indicated Date of Termination to discharge when due all obligations of the Plan with respect to guaranteed benefits.

IN WITNESS WHEREOF the Pension Benefit Guaranty Corporation has issued this Notice of Sufficiency.

AUG 27 1981

Date

Louis Spangenthal
Case Officer
Division of Case Processing, Branch 4-2

Date: [illegible]

(Signature of Plan Administrator)

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

February 8, 1984

Mr. Francis X. Lilly
Deputy Solicitor of Labor
DOL - Room S 2002
200 Constitution Avenue, NW
Washington, D.C. 20210

Dear Frank:

Attached for your information are data with regard to excess asset reversions from terminated pension plans and those pending termination at the PBGC which Senator Metzenbaum had requested from us.

Sincerely,

Kevin W. Putt
Special Assistant to the
Executive Director

Attachment

Attachment to Secretary Donovan's and Mr. Winborne's letter was not included in package just sent.

Sorry about this.

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

JAN 31 1984

MEMORANDUM FOR THE HONORABLE RAYMOND J. DONOVAN
SECRETARY OF LABOR, AND CHAIRMAN,
BOARD OF DIRECTORS - PBGC

SUBJECT INTERIM PBGC POLICY IN THE PROCESSING OF PLAN TERMINATIONS PENDING ADOPTION OF AN ADMINISTRATION POLICY POSITION RE EXCESS ASSET CASES

This memorandum supplements my memorandum to all Board members of January 10, 1984, subject as above. Since that time, numerous conferences and discussions have been held among representatives of the Department of Labor, Treasury Department, Internal Revenue Service and PBGC. The discussions centered around the articulation of PBGC policy for processing plan terminations involving use of either the "spin-off/termination" or the "termination/reestablishment" techniques described in our memorandum of January 10, 1984. In these discussions agreement was generally reached on the procedures to be recommended for PBGC Board approval with respect to spin-off/termination cases, but the agreement of the Treasury and IRS representatives was subject to a major reservation that agreement must also be reached on the procedure to be followed in termination/reestablishment cases. That agreement has not been reached.

With respect to spin-off/termination cases the PBGC procedure would be as follows:

The PBGC will inform a plan sponsor submitting a Notice of Intent to Terminate under the spin-off/termination technique that the PBGC is unable to conclude that the proposed transaction constitutes a plan termination recognizable under Title IV of ERISA and accordingly will not issue Notice of Sufficiency on an unrestricted basis. The plan sponsor will also be informed that, in order to avoid litigation and settle a disputed matter, the PBGC will be prepared to discuss conditions with the plan sponsor under which the PBGC would be prepared to issue a Notice of Sufficiency. Under this procedure, any plan sponsor desiring to settle the matter rather than litigate it will confer with the PBGC and arrive at conditions agreeable to the PBGC and the plan sponsor (as has already occurred with AMAX and Underwood). It is contemplated that, within the near future (three-four weeks), conditions to be imposed would be agreed upon by all of the involved governmental departments and agencies having responsibilities in connection with plan terminations and excess asset reversions.

A meeting was held yesterday at the PBGC offices among representatives of the Treasury Department, IRS, the Departments of Labor and Commerce and the PBGC. At this meeting a number of conditions developed by both the PBGC and the Treasury, to be imposed before a Notice of Sufficiency would be issued by the PBGC in a spin-off termination case, were generally agreed to.

With respect to termination/reestablishment cases, it has not yet been possible to achieve agreement with the Treasury/IRS representatives. DOL and PBGC appear to be in agreement. The Treasury/IRS position is that the termination/reestablishment technique is permissible under the tax laws only if conditions are imposed which, in the judgment of the Treasury/IRS, will provide adequate benefit security protection for plan participants and protect the government revenue. This position is new, having been first enunciated in a December 7, 1983 letter to me from Assistant Commissioner Winborne of the IRS.

Representatives of the Treasury/IRS urge that the PBGC should process termination cases consistently with the IRS's view. This would require the PBGC to change its existing position, and not issue its standard Notice of Sufficiency that has been issued for many years to plans terminating under the termination/reestablishment technique without imposing the same conditions on plan terminations utilizing either the termination/reestablishment technique or the spin-off/termination technique. If it does not, the Treasury/IRS assert that the PBGC procedure will undermine its ability to enforce its new position.

As Executive Director, I am reluctant to change PBGC's existing processing policy with respect to termination/reestablishment cases unless and until the PBGC Board establishes a different policy, in the absence of any compelling legal reason for changing the procedure under Title IV of ERISA. The PBGC suggests that to impose new conditions in connection with the usual termination/reestablishment case is not the most business-like way to proceed at this time and raises a legal question since to do so might be construed by a court as being in conflict with existing PBGC regulations. PBGC also notes that adoption of the Treasury's position may accelerate decisions of large companies having excess asset plans to establish a defined contribution plan instead of reestablishing a defined benefit plan.

Under the circumstances, unless and until a decision is made by the PBGC Board (presumably in accord with Administration direction yet to be given through the Cabinet Council) I believe, and Mr. Tharp concurs, that the PBGC should continue its existing procedures with respect to the issuance of Notices of Sufficiency in connection with plan terminations, utilizing the termination/reestablishment technique.

Likewise, I believe that the appropriate procedure to be followed by the PBGC in spin-off/termination situations pending Board establishment of policy on this matter, is for the PBGC to inform a plan sponsor, submitting a Notice of Intent to Terminate under that technique, that the PBGC is unable to conclude that the transaction constitutes a plan termination recognizable under Title IV of ERISA. Accordingly, the PBGC will not issue a Notice of Sufficiency unless, in order to avoid litigation and settle a disputed matter, conditions are established, prior to issuance of the Notice of Sufficiency, which are deemed appropriate and necessary under all the circumstances of a particular case. The objective is to establish conditions in conjunction with Treasury, IRS, and DOL, which could be applied to all cases, without requiring extensive negotiations on each case.

From a practical viewpoint, there are four termination/reestablishment cases now awaiting a decision which are qualified to receive a Notice of Sufficiency under our usual operating procedures, and on which the time within which we may act expires in February. The deadline on one case, involving Reynolds Metals Company and a reversion of about $130 million, expires on February 9, 1984. There are another four cases utilizing the spin-off termination technique involving about $60 million of reversions on which a decision with respect to issuance of Notices of Sufficiency must be made by the PBGC in February. There are a number of other cases which have been placed on hold which will require a decision shortly.

This memorandum does not purport to address the pros and cons of the Treasury/IRS position on a permanent basis.

Mr. Tharp and I have discussed the above with Mr. Niskanen, but no position has yet been expressed by him.

An early meeting with you on this matter is indicated.

Edwin M. Jones
Executive Director

cc: Mr. Lilly
Mr. Monks
Mr. Cowan
Mr. Niskanen
Mr. Tharp

PENSION BENEFIT GUARANTY CORPORATION

BOARD OF DIRECTORS BRIEFING DOCUMENT

Excess Asset Reversion Cases

January 9, 1984

I. OVERVIEW

Over the past six months, there has been a significant increase in activity in the Corporation, the Media, the Congress, and within the Internal Revenue Service (IRS), and the Department of Labor (DOL), relative to asset reversion cases. This attention is understandable given the increasing number of companies who have been terminating existing defined benefit plans in order to recapture any assets in excess of those required to fund the full accrued value of participants' benefits (excess assets).

Currently, ERISA provides in Section 4044(d) of Title IV that an employer (sponsor) of an on-going pension plan may not cause the plan's funds to be paid to or used by the employer. Plan funds are required to be used for the exclusive benefit of of the participants of the pension plan. However, if the plan is terminated and all participants receive their full accrued benefits in the form of purchased annuities, the law permits the excess assets to revert to the employer provided:

(A) all liabilities of the plan to participants and their beneficiaries have been satisfied,

(B) the distribution does not contravene any provision of law, and

(C) the plan provides for such a distribution in these circumstances.

Since January 1980, the PBGC has issued Notices of Sufficiency to 166 companies who have terminated their plans and obtained reversions of $1 million or more. Their total reversions amounted to $1,149 million and approximately 42% of all assets in these plans as of the date of plan termination. $566 million of that sum has reverted within the last 90 days from 36 plans. In addition, the PBGC currently has approximately 27 pending cases involving over $576 million in asset reversions. The number and significance of these cases continues to grow.

There has been a great deal of attention in Congress regarding whether asset reversions should revert to employers under existing law, especially in Congressman Roybal's Committee. This issue has been under study within the government along with two questionable techniques employers are attempting to use to obtain these excess assets. These two methods can be referred to as the "termination/re-establishment" and "spin-off/termination" techniques.

In the "termination/re-establishment" technique, an employer terminates an overfunded plan, vests all participants in benefits accrued to the date of termination, and recovers all excess assets. The employer then establishes a new defined benefit plan which is substantially similar to the prior plan. This new plan covers all active employees who accrue benefits for service rendered after establishment of the new plan. The benefit formula usually calls for calculation of a total benefit on the basis of all service with the employer, which is then offset by the value of purchased annuities under the old plan. The PBGC currently has five (5) of these cases pending involving approximately $200 million in asset reversions. One case alone involves a reversion of approximately $130 million.

The "spin-off/termination" technique occurs when an employer spins off from its overfunded plan its active employees to a new plan, leaving only retired employees as participants of the overfunded plan. The employer allocates minimal assets to the new plan, thus leaving all excess assets in the plan covering only retired employees. Then ~~the employer~~ promptly terminates the plan covering only retired employees thereby obtaining a reversion of all excess assets. The active employees covered under the new plan are not given vested status as to their accrued benefits under the old plan, nor are they guaranteed annuities purchased from a private insurance company with respect to such benefits, as would be the case if the old plan had been completely terminated. The PBGC currently has 15 of these cases pending involving approximately $201 million in asset reversions, including AMAX which would involve an estimated $162 million reversion, but for the special arrangement negotiated with AMAX.

The principle effect of both techniques is that the employer is able to obtain most, if not all, excess assets from the existing plan while continuing a qualified defined benefit plan for all active employees.

While most of the inter-agency attention has focused on attempts by employers to use the above techniques in terminating overfunded plans, the PBGC is and has been concerned about the possibility of some employers attempting to use these techniques in underfunded plans, thereby dumping an immediate liability on the PBGC and abusing the insurance system. Their attempt would be on the theory that a plan "termination" has occurred which the PBGC must recognize as a termination triggering PBGC liability under the statute.

Regarding overfunded cases, the Treasury/IRS have recently issued a proposed policy regarding the use of the above two techniques. Their proposed policy as to "termination/re-establishment" cases represents a significant change from their previous position which allowed the use of this technique without restriction for many years. Their proposed policy as to "spin-off/termination" cases is in line with the PBGC's view that a "termination" recognizable under Title IV of ERISA by the PBGC has not occurred.

The new proposed Treasury/IRS policy and the pending

Administration review of overall pension policy, including asset reversions and those questionable techniques, raises the question as to what the PBGC's interim policy should be relative to the processing of excess asset cases. This is important, since with a statutory 90-day processing period for sufficient cases, the PBGC represents the "front line" in pension policy relative to issues involving terminations. In this connection, it is noted that current Treasury/IRS regulations recognize the PBGC's right to determine "what is a termination." Given current regulations, any actions taken by the PBGC have an immediate impact on the pension community and serve a precedent to other agencies and the Administration in various policy reviews. Under their new position, the IRS would be reserving the right to determine that a plan termination which is processed by the PBGC as a termination for Title IV purposes may not be recognized as a termination for IRS purposes under various code provisions. The potential adverse tax consequences of such a determination to the employer/sponsor and to the employees are huge since the IRS is proposing to disqualify both the new and old plans.

Therefore, the PBGC is requesting policy advice as to how it should process pending cases, until such time as the Administration has had time to fully examine all aspects of this matter.

The following represents a summary of the four major types of transactions which result in employers obtaining excess assets from overfunded plans. The summary represents current PBGC policy, the new proposed Treasury/IRS policy, impact of the proposed policy on the PBGC, interim policy options, and our recommendations for your consideration.

II. ISSUE TO BE ADDRESSED

What should the PBGC's interim policy be with respect to processing asset reversion cases in light of the proposed Treasury/IRS policy and the pending administration review of overall pension policy, including the asset reversions issue?

III. SUMMARY OF CURRENT POSITIONS BY MAJOR ASSET REVERSION CATEGORIES

A. Termination/Re-establishment (Defined Benefit Plan)

1. Current PBGC Policy:
The PBGC has been reviewing these cases for possible abuse of the insurance system (i.e., insufficient plan terminations, and sufficient plan terminations involving asset reversions where net worth may be limiting should the new plan terminate with an insufficiency). If the PBGC is able to satisfy itself that an abuse was not apparent, these cases have been processed to completion and Notices of Sufficiency have been issued as appropriate. The PBGC has felt it should be more flexible in the "termination/re-establishment" type situation due to the much greater difficulty companies have in effectuating this type of transaction versus a "spin-off/termination" and our concern not to force companies to leave the defined benefit system in order to obtain these reversions. Therefore, the PBGC has processed "termination/re-establishment" cases and issued Notices of Sufficiency when the PBGC was able to satisfy itself in a review of the facts that an abuse of the insurance system was not present. Such terminations appear to have a reasonable legislative basis, and PBGC's practice avoids forcing companies to leave the defined benefit system in order to obtain excess asset reversions.

2. Proposed Treasury/IRS Policy:
The proposed Treasury/IRS policy represents a major change from their previous position regarding this type of transaction. They plan to review these cases on a facts and circumstances basis towards imposing a "step transaction" doctrine where appropriate. If the "step transaction" doctrine is applied, it would recognize that the transaction was, in effect, drawing assets from an on-going plan in violation of the Code, thus disqualifying the plan.

3. Impact of Proposed Treasury/IRS Policy:
This proposed policy is in conflict with our recent and prior practice of issuing Notices of Sufficiency

where abuse of the insurance system is not apparent. It is also in apparent conflict with current IRS regulations which provide that they recognize the PBGC's right to determine " what represents a termination" and will therefore follow our lead. As noted above, the PBGC has several cases involving this type of transaction which require a decision before February 1, 1984.

B. Spin-off/Termination:

1. Current PBGC Policy:
At present, the PBGC is not issuing Notices of Sufficiency in these cases in light of our legal and policy concerns as to whether a termination under Title IV exists. We have been requesting extensions on these cases before the statutory processing period expires. However, most of the recently negotiated extensions expire on or before February 1, 1984. Given the amount of time that some of these cases have been pending and the prior reluctance of these employers to grant us extensions, the PBGC must be prepared to take a definitive policy position on these cases before February 1, 1984.

The PBGC recently reached an agreement with AMAX Inc.with regard to its proposed "spin-off/termination" which provided additional protection to the PBGC and plan participants and beneficiaries over and above that available under a plan termination utilizing the " termination/re-establishment" technique. This included fully vesting participants to the extent to accrued benefits, the purchase of annuities for such benefits and allocation of approximately $62 million in excess assets out of a total of $163 million to the on-going plan segment. The agreement's implementation is subject to AMAX receiving a favorable final determination letter from the Internal Revenue Service and the absence of any adverse legislation in the interim which would effectively prohibit the reversion. Therefore, the PBGC will not issue a Notice of Sufficiency unless and until these contingencies are met. We are not presently negotiating with any other employers proposing this type of transaction.

2. Proposed Treasury/IRS Policy:
The proposed Treasury/IRS policy views these cases from two perspectives. The first is based on a review of the facts and circumstances in each case towards applying a "step transaction" doctrine where appropriate. This would state that assets have been removed from an on-going plan in

violation of the Code, thus affecting plan qualification. Presumbly, the IRS would base its decision on whether there was a legitimate reason for the termination other than the desire to obtain the excess assets for use by the plan sponsor. Should the sponsor satisfy this test they would employ a second approach. This approach, which is termed the "actuarial error" approach, would effectively disallow any reversion under the long standing provision of the Code which only allows a reversion of excess assets which results from "actuarial error" (i.e., where actual experience as to earnings, mortality and expenses turns out to be different from assumptions made in calculating required contributions to the plan). The reason for the disallowance according to the IRS, is that the reversion would result from a conscious decision of the employer to terminate the plan and not from "actuarial error." This proposed IRS policy position would seem to effectively close off the typical "spin-off/termination" technique.'

3. Impact of Treasury/IRS Position:
The new Treasury/IRS position would be consistent with PBGC's position that this technique should not be recognized by the PBGC as an allowable termination for Title IV purposes under existing law. However, this policy will apparently result in non-implementation of the recently negotiated AMAX/PBGC settlement. In addition, it would effectively preclude the PBGC from entering into negotiations for protective conditions in lieu of litigation with other companies proposing this technique.

C. Termination/Re-establishment (Defined Contribution Plan):

1. Current PBGC Processing:
The PBGC is processing all cases involving this type of transaction and issuing Notices of Sufficiency as appropriate. ERISA appears to specifically provide for this option to employers under Sec. 4041(f). Obviously, uncertainty as to whether an employer can recover excess assets under the " termination/re-establishment" technique where a new defined benefit plan is established in place of a terminated plan, is impelling employers to establish defined contribution plans in place of defined benefit plans. This results in a loss of premium dollars to the PBGC. Unfortunately, this has already occurred in two recent cases involving large employers who decided to start a defined contribution plan rather than stay with a defined benefit plan in order to obtain the reversion

expeditiously and avoid any legal questions.

2. Proposed Treasury/IRS Position:
The new Treasury/IRS position does not address this type of transaction. Apparently, they plan to continue to issue favorable determination letters in these cases except in instances involving improper transactions.

3. Impact of Proposed Treasury/IRS Policy:
Since the IRS did not address this type of transaction, there is no impact on the PBGC's present policy.

D. Termination/No New Plan

1. Current PBGC Processing:
The PBGC has been processing these cases and issuing Notices of Sufficiency as appropriate. It does not have any basis under Title IV for not processing these cases.

2. Proposed Treasury/IRS Position:
The IRS does not address this type of transaction in its proposed policy.

3. Impact of Proposed Treasury/IRS Policy:
Since the IRS did not address this type transaction, there is no impact on the PBGC's present policy.

IV. Interim Options Available to the PBGC by Asset Reversion Category

A. Termination/Re-establishment (Defined Benefit Plan)

1. Continue PBGC's present practice of reviewing for potential abuse of the insurance system and, assuming abuse was not apparent, issuing Notices of Sufficiency.

2. Change the PBGC's present practice and advise the employers that the PBGC is not processing cases of this type until the IRS determines that this technique does not disqualify the plan for tax purposes.

3. Change the PBGC's present practice and advise the employer that the PBGC finds no basis for processing this type transaction as a termination under Title IV.

B. Spin-off/Termination:

1. Reject these cases as not representing valid terminations under Title IV.

2. Attempt to negotiate protective terms along the lines of those included in the AMAX settlement. The PBGC would reject any filings where an acceptable agreement could not be reached.

3. Recognize this technique as a valid way of terminating a plan and recovering excess assets without negotiating any special conditions.

C. Termination/Re-establishment (Defined Contribution Plan)

1. Process these cases in a normal manner and issue Notices of Sufficiency.

2. Process these cases with an added review for possible improper transactions within the past several years.

D. Termination/No new Plan

Same as "C" above.

V. Recommendations for Interim Policies

1. Termination/Re-establishment (Def. Benefit Plan)
The PBGC's view is that it should continue to follow its current practice of reviewing these cases for potential abuse of the insurance system. Should the PBGC satisfy itself that an abuse is not apparent, it would issue a Notice of Sufficiency. In addition, unless there is a change in the recently expressed IRS position, PBGC proposes to add a statement to its usual Notice of Sufficiency indicating that its issuance is not to be deemed an approval of the proposed reversion. The employer would thus be put on notice that the reversion might be questioned. This approach may be constructed as an apparent inconsistency between agencies, but would provide a way for companies that are intent on obtaining their excess assets to stay in the defined benefit system. If the IRS were to withhold implementation of its recently expressed views on "termination/re-establishment" cases, the apparent inconsistency would not exist and the additional statement would not be needed.

2. Spin-off/Terminations
Accepting the IRS' recently announced position, and in the absence of any new legislation, the PBGC's view is that these transactions should be rejected as not representing valid terminations under Title IV. The PBGC would not consider each case on a facts and circumstances basis.

This rejection policy would be consistent with the proposed Treasury/IRS policy.

3. Termination/Re-establishment (Def. Contr. Plan)
The PBGC's view is that it should continue to process

these cases and issue Notices of Sufficiency as appropriate. However, we would begin sending out questionaires for all such cases involving asset reversions of $1 million or more,in order to ascertain whether any partitioning of the plan had taken place within the past several years. Should PBGC discover any improper transactions, it would follow-up with IRS and DOL if appropriate, prior to issuing any Notices of Sufficiency. If no improper transactions were discovered, we would issue a Notice of Sufficiency for the terminated defined benefit plan.

4. Termination/No New Plan
The PBGC's view is that it should continue to process these cases and issue Notices of Sufficiency in an unrestricted manner.

Asset Reversions

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

Edwin M. Jones
Executive Director

JAN 1 0 1984

MEMORANDUM FOR THE HONORABLE RAYMOND J. DONOVAN
SECRETARY OF LABOR, AND CHAIRMAN,
BOARD OF DIRECTORS - PBGC

THE HONORABLE DONALD T. REGAN
SECRETARY OF THE TREASURY

THE HONORABLE MALCOLM BALDRIGE
SECRETARY OF COMMERCE

SUBJECT: INTERIM PBGC POLICY IN THE PROCESSING OF PLAN TERMINATIONS PENDING ADOPTION OF AN ADMINISTRATION POLICY POSITION RE EXCESS ASSET CASES

An increasing number of defined benefit plan terminations under various techniques has raised the basic question as to whether such terminations should be recognized as valid terminations by the PBGC and by the IRS, thus entitling employer-sponsors to receive from the plan all assets in excess of the amount required to satisfy all plan liabilities to participants and their beneficiaries.

Since January 1980 the PBGC has issued Notices of Sufficiency to 166 companies which have terminated their plans and obtained reversions of excess assets in the amount of $1 million or more. The total amount of such reversions is approximately $1,150 million, equivalent to 42% of all assets of such plans as of the date of a termination. Of these amounts $566 million, or almost 50% of the total, has reverted in the last 90 days, from 36 plans. In addition the PBGC has 27 pending cases involving about $576 million in asset reversions. Much press attention has been given to this matter. Congressional hearings have been held and further Congressional inquiry is underway.

Two termination techniques are being used by employers in seeking to obtain a reversion of the excess assets. One technique can be referred to as the "termination/reestablishment" technique and the other as the "spin-off/termination" technique.

Termination/Reestablishment Technique

This technique involves the termination of a defined benefit pension plan and the concurrent establishment of a "new" plan with substantially the same benefits and features as the "terminated" plan. Assets of the terminated plan are utilized to the extent necessary to buy annuities from an insurance carrier for all benefits of all participants accrued to date of termination. Assets in excess of the cost of the annuities are then paid over from the plan to its employer-sponsor. The effective result is similar to a continuation of a terminated pension plan, minus the excess assets that reverted to the employer-sponsor. If the "terminated" plan has more funds than are necessary to buy annuities for all accrued benefits of all participants, the effective result is similar to a continuation of the terminated pension plan without the excess assets that reverted to the employer-sponsor.

The amount of excess asset reversions in these cases has been particularly large during recent time periods, because interest rates have been high and plan annuity benefits can therefore be purchased from insurance companies at unusually low single premium rates. For example, the employer might have contributed funds to the plan on the assumption that plan assets would earn 7% to 8% over the long term. During recent years, and currently, annuities for all plan participants can be purchased from an insurance company on a 12% to 13% basis. The differential results in "excess" assets no longer needed to pay off all annuity benefits under a pension plan. Other factors such as higher equity prices contribute to the size of the excess. In view of the large sums involved, employers are understandably anxious to take advantage of high interest rates, recapture the excess and utilize it for general corporate purposes.

This technique of achieving excess assets has been used by employers during all the years that ERISA has been in existence, and for many years prior thereto, even when interest rates were lower. In the early part of 1983 the use of this technique was reviewed by officials of the DOL, Treasury Department, IRS and PBGC. The IRS, Treasury Department and DOL expressed no concern about continued use of that technique and the PBGC has continued to process these cases without raising any question as to the existence of a valid plan termination. Similarly the IRS has regularly issued favorable determination letters for many years with respect to the continuing tax qualification of the ongoing plan and of the terminated plan.

Obviously, since the terminated plan has excess assets, it is a "sufficient" plan from the PBGC's viewpoint, and there can be no loss to the PBGC at time of termination. A potential loss might subsequently emerge if the reestablished plan is later terminated in an insufficient position, and any such risk is hard to quantify. Accordingly, there is no business reason for the PBGC not to process the termination.

If, however, the terminated plan did not have sufficient assets to cover the guaranteed benefits, the terminated/reestablishment technique would not be recognized by the PBGC.

The recent position enunciated by the IRS in the attached letter to the Executive Director of the PBGC presents the issue as to whether the PBGC should continue to process termination/reestablishment cases in the same way as it has since its inception. There has been no change in the law on which to base a different position. However, it is significant that the IRS now takes the position that the termination/reestablishment technique results in an improper disposition of assets from an ongoing plan in violation of the Code, except in unusual cases. This position raises a question as to whether a distribution of excess assets to the employer, usually thought to be permissible under ERISA Section 4044(d) in Title IV, is permissible because it would not meet one of the Section 4044(d) requirements that the distribution must not "contravene any provision of law." If the IRS position is maintained, the issue is presented as to whether the PBGC should continue its former practice in the face of Section 4044(d) of the law.

Options for the interim period available to the PBGC with respect to termination/reestablishment cases appear to be as follows:

1. The PBGC could continue to process plan terminations utilizing the termination/reestablishment technique. This would mean that the PBGC would continue to issue a Notice of Sufficiency in the usual way. However, in light of the recently expressed IRS position, it would include an additional statement in the Notice of Sufficiency to the effect that the PBGC Notice of Sufficiency is not to be deemed approval by any governmental agency of any excess assets reversion. The employer would thus be put on notice that the reversion might be questioned. The additional statement would not be included if the recently expressed IRS position is to be held in abeyance and the former practice of recognizing the termination/reestablishment technique is continued.

2. A second option is for the PBGC to change its present practice and advise the employer that the PBGC is not processing cases of this kind until the IRS determines that the termination/reestablishment technique does not disqualify the plan. The use of this procedure would be limited because the PBGC is faced with the requirement that it has only 90 days from date of receipt of the Notice of Intent to Terminate within which to issue a Notice of Sufficiency or to advise the employer that PBGC is unable to determine that the plan is a sufficient plan. In the type of case under consideration there is usually no basis for the PBGC's advising the employer that it is unable to determine whether the assets are sufficient, since they clearly are sufficient. Accordingly, the legal basis for this option is uncertain and the PBGC might be forced in litigation to issue a Notice of Sufficiency.

3. A third option is to advise an employer which files a Notice of Intent to Terminate under the termination/reestablishment technique, that the PBGC finds that no plan termination has occurred and therefore has no basis for processing the case as a terminated plan. Whether such a position would hold up in court is debatable. It would be in the face of resolutions of the employer's board of directors resolving to terminate the existing plan, providing for the vesting of all benefits accrued to date of termination which might not otherwise be vested for a period of years, and for the purchase of annuities from an insurance company which fully protects the employees. In addition, the employer often provides for a benefit increase and may adopt amendments to the new plan making it somewhat different from the old plan. In the face of these facts it is questionable whether the PBGC would be able to sustain this option if it were to be contested in litigation.

From the PBGC's viewpoint the first option seems preferable. It would give recognition to the fact that formal legal steps required to terminate a plan have been taken which include vesting and other features noted above. It would in effect not conflict with the current IRS position that it wishes to review each case on a facts and circumstance basis regarding the appropriateness of the employer's obtaining a reversion under the particular facts of the case. It has the disadvantage of being confusing to the public, since the IRS would presumably often conclude that the reversion is not permissible. Also it may lead many employers to decide to terminate their pension plans and substitute defined contribution plans instead of reestablishing a defined benefit plan. These disadvantages would disappear if the IRS were to modify its recently expressed position.

Spin-Off Termination Technique

The "spin-off/termination" technique occurs when an employer spins off from its overfunded plan its active employees to a new plan, leaving only retired employees as participants of its overfunded plan. The employer transfers minimal assets from the overfunded plan, to the new plan, thus leaving all excess assets in the plan covering only retired employees. The employer promptly terminates the plan covering only retired employees thereby obtaining a reversion of all excess assets. The active employees covered under the new plan are not given vested status as to their accrued benefits under the old plan, nor are guaranteed annuities purchased from a private insurance company with respect to such benefits as would be the case if the old plan had been completely terminated under the termination/reestablishment technique.

The PBGC has been reluctant to recognize this type of case as a valid "termination" of a plan. All that has happened in substance from an economic viewpoint is that the plan has bought annuities for the retired employees. It believes that at best it would be a partial termination of a plan. A partial termination has never been recognized as triggering PBGC guarantees. Plans with unfunded liabilities could in effect shift unfunded liabilities for retired employees to the PBGC, and create massive losses for it.

The IRS position on this technique is that the termination should not be recognized for two reasons. One reason (also applicable in connection with the termination/reestablishment technique) is that the substance of the transaction amounts to removing assets from an ongoing plan which is a violation of the Code. The second reason is that the reversion would result from a conscious decision by the employer to terminate the plan and not from an "actuarial error" which, if it existed, could properly result in a reversion of excess assets to the employer.

The options available to the PBGC appear to be as follows:

1. The first option would be to reject all submissions under the spin-off technique as not representing a valid filing with the PBGC under Title IV. Such rejection would be in accord with the IRS position and would reflect the basic view that there has not been any termination of a plan in substance. The essence of the transaction is that the plan has simply purchased annuities for retired employees, and the employer-sponsor has caused excess plan monies to be transferred to itself. From the active participant's viewpoint, the transaction on its face might look as though there has been no change in his or her rights, but the fact is that the plan's assets have been substantially depleted. The employee's security has also been weakened. If

this option were adopted, there is a possibility that in litigation a court would not agree with the PBGC's analysis. Nevertheless, this option seems to be the best of the alternatives.

2. A second option pending a final policy decision on the issues involved would have the PBGC proceed to deal with each case and try to obtain acceptable protective terms and conditions as was done with AMAX, Inc. (See Attachment). This would require substantial negotiations with sponsors who wish to utilize this technique. It would be tantamount to negotiating a settlement in lieu of litigation. From an administrative point of view it has obvious time and cost drawbacks. Furthermore, many employers would not agree to the terms that AMAX has agreed to, one of which results in AMAX's giving up a reversion of approximately $62 million out of a total of $163 million that would otherwise revert to AMAX under a total plan termination. If a negotiated agreement is reached, the employer is then faced with getting approval from the IRS. Such approval may not be granted in many cases, on the basis of IRS presently expressed views. If a negotiated agreement is not reached, the PBGC would reject the filing. Accordingly, this option is not considered by the PBGC to be preferable to the first option.

3. The third option is to recognize the spin-off/termination technique as a valid technique of terminating a plan and recovering excess assets. This option is contrary to the Treasury/IRS position, as presently expressed, and to the position taken by the PBGC to date. From a legal viewpoint, given the IRS's present position, the legality of the option is questionable. It is not recommended by the PBGC.

Termination of Defined Benefit Plans, and Concurrent Establishment of a Defined Contribution Plan

No major change is under consideration in the PBGC's processing of cases in which a defined benefit plan is being terminated concurrently with the establishment of a defined contribution plan. It is likely that the PBGC will inquire further as to whether there have been any related spin-offs within recent time periods prior to termination. Coordination with the IRS on this type of case will be effected.

Termination of Defined Benefit Without Any New Plan Being Established

The PBGC would continue to process these cases in normal fashion, without any change in practice.

Administration Policy

This memorandum does not address the issues involved in establishing a final Administration policy on whether

(1) The termination/reestablishment technique used for many years should be endorsed as a valid technique for the employer's obtaining all excess assets in terminated plans.

(2) The spin-off/termination technique should be recognized as a valid new technique for achieving excess asset reversions.

(3) Legislation should be sought that would address the various elements of excess assets reversions which are currently under scrutiny. Such elements would among others include the required retention of some portion (or all) of the excess assets for increasing plan benefits to employees, or the required retention in the new plan of some portion (or all) of the excess assets as further protection to the PBGC and employees should the employer's business decline in the future.
    If a legislative initiative is to be mounted by the Administration, consideration should be given to incorporating some or all of the essential features negotiated with AMAX and set forth in the PBGC agreement AMAX.

Overall the PBGC thinks it is important to encourage employees to maintain defined benefit plans, and any final Administration policy should reflect that objective.

Edwin M. Jones
Executive Director

Attachments

Internal Revenue Service Department of the Treasury

Assistant Commissioner
(Employee Plans and
Exempt Organizations)

Washington, DC 20224

DEC [illegible] 1983

Mr. Frank Lilly
Deputy Solicitor
U. S. Department of Labor
Room S-2002
200 Constitution Avenue, N.W.
Washington, DC 20216

Dear Frank:

Approximately two weeks ago, in a meeting including you, Buck Chapoton, Ed Jones and me, the AMAX case was discussed in connection with a PBGC settlement. We agreed that the case may be settled in accordance with Ed Jones' proposal as long as such settlement did not adversely impact on the prerogatives of any other agency. At that meeting you indicated that the application of the "substance over form" doctrine involved not only tax policy but pension policy in general and you requested that such policy should not be adopted before obtaining the Department of Labor's concurrence.

Since that meeting, the PBGC has settled according to the lines previously agreed to and the AMAX case has been sent to the National Office of IRS under the technical advice procedure. We, therefore, must resolve this issue.

The facts in this case are fairly simple. AMAX has split its defined benefit pension plan into two plans, a plan for retired lives and a plan for active employees. Such split presumably satisfied section 414(l) of the Internal Revenue Code and section 208 of ERISA. The plan at the time of the split had surplus assets. Over $100,000,000 of surplus assets were allocated to the plan for retired lives. The retired life plan was subsequently terminated and AMAX requested a reversion which is in excess of $100,000,000.

We have concluded that in AMAX's case the plan was split into retired and active lives solely as a device to obtain the reversion while permitting the employer to maintain its defined benefit plan. Under the Code, assets in excess of present value of accrued benefits may not revert to the employer prior to a plan's termination. The split of the plan coupled with the termination of only the retired person would be in our view a device designed to avoid the statutory nonreversion requirement. Accordingly, the termination would not be bona fide and no surplus may revert to the employer. We also believe that although the PBGC settlement may decrease the extent of the abuse, it is fundamentally inconsistent with the "substance over form" doctrine.

Mr. Frank Lilly

We would like to meet with you on Tuesday, January 10, 1984 at 9:00 a.m. in my office to discuss this case and agree on what actions should be taken. We are under considerable pressure to resolve this case quickly. Members of the Treasury Department, PBGC, and our Chief Counsel's Office will be invited. Please bring anyone you believe to be appropriate. If there are any technical questions or issues you or anyone on your staff would like resolved prior to the meeting, contact Ira Cohen on 566-6740.

Sincerely,

J. Allen Winborne

J. Allen Winborne

cc: Roscoe Egger
John Chapoton
Robert Monk
Ed Jones
Pete Scott

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

RECEIVED
U.S. DEPARTMENT OF LABOR
LABOR MANAGEMENT SERVICES
ADMINISTRATION OPS/ORPS/OCPS

JAN 3 1984
AM
7,8,9,10,11,12,1,2,3,4,5,6
PM

DEC 29

Alan D. Lebowitz, Assistant Administrator
Office of Fiduciary Standards
U.S. Department of Labor
Room C4526
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Dear Mr. Lebowitz:

At the present time, PBGC is not issuing a notice of sufficiency to plans that have a potential reversion to the sponsor and have either been involved in a spinoff or are proposing to cover participants in a successor defined benefit plan. Attached is a list of cases currently pending at PBGC. We are anxious to coordinate with DOL on the processing of these types of cases. Please inform me of any cases relating to a spinoff or successor defined benefit plan pending at DOL that are not on the attached list. If you wish to discuss specific cases, you may contact Harvey Lebson, Deputy Manager of the Case Processing Division.

Sincerely,

William M. DeHarde, Director
Insurance Operations Department

EXCESS ASSETS

A. Plans involving spinoff

Plan Sponsor	Assets	Benefits	Reversion	EIN-PN
Frank B. Hall (Briarcliff Manor, NY)	$ 26.1M	$ 7.6M	$ 18.5M	135518197-001
~~Denver Broncos (Denver, CO)~~	~~.5M~~	~~.2M~~	~~.3M~~	[illegible]
Inco Electric (Philadelphia, PA)	58.8M	24.3M	34.5M	232051246-016
Brown Boveri (N. Brunswick, NJ)	45.6M	27.8M	17.8M	135522207-001 363100018-002,101,102 (Represents 4 plans)
Forsyth (Houston, TX)	1.2M	.3M	.9M	741675555-001
Springfield Photo (Holyoke, MA)	.9M	.4M	.5M	041859430-002
Underwood (Westwood, MA)	10.3M	6.0M	4.3M	041919830-001
Butler Manufacturing (Kansas City, MO)	25.0M	13.0M	12.0M	440188420-002,003,032,033,102 (Represents 5 plans)
AMAX (Greenwich, CT) 1/	189.0M	65.0M	124.0M	134923460-003
General Refractories (Bala Cynwyd, PA)	6.6M	.57M	6.03M	230161800-105
Rapid Roller (Chicago, IL)	1.06M	.86M	.2M	362846979-002
Texstar (Pittsburgh, PA)	2.6M	.4M	2.2M	310716613-001,002 (Represents 2 plans)
Norlin Industries (White Plains, NY) 2/			10.8M	360902970-001,006,021 (Represents 3 plans)
Maywood (Amarillo, TX)	4.5M	1.5M	3.0M	750855707-001
15. Pako (Minneapolis, MN) 3/	9.4M	3.0M	6.4M	410464650-002

1/ PBGC has entered into an agreement with AMAX that will result in an additional $62 being transferred to the ongoing plan and a reduction of $62 in the amount of the reversion.

2/ Data on assets and benefits are not available. The plan sponsor has indicated that the spinoffs will be reversed and new termination notices filed.

3/ Plan assets were distributed without a Notice of Sufficiency being issued.

EXCESS ASSETS

B. Plans where participants will be covered under a successor defined benefit plan.

Plan Sponsor	Assets	Benefits	Reversion	EIN-PN
5 [redacted]	[redacted]	[redacted]	[redacted]	510003820-001
[redacted]	[redacted]	[redacted]	[redacted]	540355135-001
Allied Supermarket (Detroit, MI)	12.0M	7.0M	5.0M	381623900-010
National Savings Bank (New Haven, CT) 1/	1.5M	.9M	.6M	060464960-001
Lynchburg Foundries (Lynchburg, VA)	41.5M	25.8M	15.7M	310831755-001,005,007 (Represents 3 plans)

1/ National Savings Bank merged with People's Savings Bank, with People's being the survivor. The excess assets would revert to People's.

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply to:

Date:

DEC 28 1983

RECEIVED
DEC 28 '83
OFFICE OF
FIDUCIARY STANDARDS

Mr. Alan D. Lebowitz
Assistant Administrator
for Fiduciary Standards
Pension and Welfare Benefit Programs
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20216

Dear Mr. Lebowitz:

Pursuant to your request, attached is a copy of our memorandum returning Cities Service Company Retirement Income Plan (#017) to the Key District Director for issuance of a favorable determination letter on the Plan termination.

Sincerely yours,

Ira Cohen

Ira Cohen
Director, Employee Plans
Technical and Actuarial Division

Enclosure

Internal Revenue Service
memorandum

RECEIVED
DEC 28 '83
OFFICE OF
FIDUCIARY STANDARDS

date: DEC 2 8 1983

to: District Director
Dallas Key District
Attn: Chief, EP/EO Division

from: Director, Employee Plans Technical and Actuarial Division OP:E:EP
National Office

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subject: Cities Service Company Retirement Income Plan (#017)

We have considered certain issues regarding the above-described Plan which was forwarded to us in connection with our study involving terminating defined benefit plans with significant amounts of asset reversions to the employer.

Information provided by the employer at the request of the National Office resulted in our questioning the May 1, 1983 transfer of liabilities without a correlative transfer of assets from the Plan.

In order to secure our approval of the termination of the Plan, Cities has agreed to take all actions necessary to reverse the May 1, 1983 transfer. Cities will transfer the liabilities of the Refining Marketing and Transportation Operations ("RMT") salaried employees and the Columbian Chemicals salaried employees from the Cities Service Company ("CSC") Hourly Plan to the Cities Service Company Salaried Plan. With respect to the RMT salaried employees, Cities will make available with respect to the CSC Salaried Plan, the options currently available with respect to the CSC Hourly Plan. With respect to the Columbian Chemicals salaried employees, Cities will cause the trustee of the CSC Salaried Plan to purchase a single premium non-participating deferred annuity contract equal to each such employee's frozen accured benefit under the CSC Salaried Plan.

The effect of this transfer will be to reduce the amount of surplus assets held by the CSC Salaried Plan by an amount approximately equal to $38.5 million and increase the amount of surplus assets held by the CSC Hourly Plan by the same amount. However, there will be no effect on the accrued benefits attributable to or the options available to the transferred employees.

You should issue a favorable determination letter with respect to the termination of this plan if you conclude that such a letter is otherwise appropriate. Any such letter should be conditioned upon the actual performance of this agreement.

Please send Part 3 of the enclosed Form 3210 to its orginator.

Attachments:
Two copies of this memorandum
Key District Office case files

Copy of this memorandum to ARC (EP/EO) Southwest Region
Copy of this memorandum to OP:E:EP:D

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

December 20, 1983

Mr. Francis X. Lilly
Deputy Solicitor
Department of Labor
Room S 2002
200 Constitution Avenue, NW
Washington, D.C. 20210

Dear Mr. Lilly:

As in the past, I am enclosing for your information a copy of materials recently sent to Congressman Roybal in further response to his request of October 16, 1983.

Sincerely yours,

Edwin M. Jones
Executive Director

Enclosures

EDWARD R. ROYBAL, CALIF.
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JORGE J. LAMBRINOS
STAFF DIRECTOR

U.S. House of Representatives
Select Committee on Aging
Washington, D.C. 20515
Telephone (202) 226-3375

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PAUL SCHLEGEL
MINORITY STAFF DIRECTOR

October 16 1983

Mr. Edwin Jones
Executive Director
Pension Benefit Guaranty Corporation
2020 K Street, Suite 7000
Washington, D.C. 20006

Dear Mr. Jones:

Thank you for your prompt response to my letter of July 26, 1983. The answers provided to the questions I had posed were very helpful to me in crystalizing the issues that were subsequently discussed at our hearing on September 28, 1983. The data you supplied in response to my request have proven to be of great value and interest as the committee continues to investigate the current trend of "overfunded" defined benefit pension plan terminations.

This letter is a follow-up to the request made on July 26, 1983. The committee would like to receive an updated list of plan terminations which have resulted in reversions of $1 million or more, covering terminations from 1-1-80 to present (most recent available statistics). The committee additionally requests that the data included on the list of terminated plans be amended to include the date on which the plan was terminated, as well as the interest rate used to calculate any lump-sum distribution of accrued benefits following plan termination. This would permit the committee to more accurately evaluate the current trend of terminations. The committee would also like to obtain a listing of those applications presently pending before the Corporation in which a potential reversion may exceed $1 million or more.

Thank you for your continuing assistance to the committee with regard to this request. If you have any questions about the updated request, please contact Roger Thomas, the committee's pension counsel, at 226-3375.

Sincerely,

Edward R. Roybal

Edward R. Roybal
Chairman

ERR/sd

Reversion of Excess Assets Greater than $1M

DOPT	Sponsor	Reversion	Lump Sum Interest Assumptions
9/22/83	Mattel, Inc.	13,992,000	7%
7/31/80	STP Corporation	1,031,139	not available
7/31/83	Beker Industries Corp	4,042,012	annuities purchased
6/30/83	Armstrong Containers Inc.	1,376,654	9.25%
6/30/83	Merchants Mutual	3,117,701	not available
12/15/80	Sharson Steel Corp	1,999,673	not available
6/18/83	Dan River Inc.	11,490,534	12.25%
9/30/80	Valley Nitrogen Producers Inc.	1,260,000	not available
6/05/83	Grunau Co. Inc.	1,598,001	annuites purchased
5/31/83	Miller and Co.	1,148,802	annuities purchased
6/01/83	Searle Medical Products USA	2,283,994	9%
6/02/83	Casa Ford Inc.	1,019,830	not available
6/13/83	Baldwin Holding Co.	2,960,895	8.5%
6/10/83	Baldwin Holding Co.	1,519,151	8.5%
5/16/83	Alabama Metal Industries Corp.	1,525,988	not available
6/30/83	Seymour Foods Inc.	1,158,139	annuities purchased
6/15/82	Smith Jones Inc.	1,918,254	not available

DOPT	Sponsor	Reversion	Lump Sum Interest Assum
5/12/81	Air California	1,078,266	9.5%
5/09/83	Sieco Inc	11,533,015	5%
4/15/83	Butler Manufacturing Co.	4,562,742	annuities purchased
12/31/82	Unicorn Industries, Inc.	1,331,427	annuities purchased
4/04/83	Goldenberg Plywood & Lumber	1,191,690	5%
3/31/83	Searle Optical Inc.	3,655,414	not available
6/01/83	Searle Medical Products USA	1,196,517	9%
3/31/83	Patterson Dental Co.	2,771,272	annuities purchased
3/31/83	Globe Ticket Co.	1,012,317	annuities purchased
8/31/81	Harper & Row Publishers, Inc.	10,189,000	15%
3/31/83	Globe Ticket Co.	2,100,979	annuities purchased
3/28/83	Lansing B. Warner, Inc.	1,254,711	9.75%
6/30/83	United Nuclear Corp.	5,855,455	annuities purchased
3/05/83	Rio Indal, Inc.	1,201,170	9.5%
2/28/83	Fedders Corp.	2,651,000	annuities purchased
10/30/81	Kahn & Feldman, Inc.	1,708,252	not available
3/11/83	Bobbie Brooks, Inc.	6,018,000	11.75%
2/26/83	Lindsay Wire Weaving, Co.	2,090,000	9.75%
1/31/83	Houdaille Industries, Inc.	2,823,979	annuities purchased

1/27/83	Nebraska Furniture Mart, Inc.	1,818,291	8%
1/13/83	Family Health Assoc of Arizona	1,521,012	10 3/4%
12/17/81	Triangle PWC, Inc.	1,917,239	annuities purchased
9/12/82	Branch Motor Express Co	4,531,914	not available
12/30/82	Whirlpool Corp	1,099,509	annuities purchased
12/28/81	Bank of the Commonwealth	11,989,901	annuities purchased
12/31/82	National Sharedata Corp	1,092,775	annuities purchased
12/31/82	Mobex Corp	1,156,140	10 1/4%
12/27/82	Host Int'l, Inc.	4,221,729	8%
1/01/82	Prudential Lines, Inc	1,289,249	10.5%
12/31/81	Equitable General Ins.	4,473,329	6 1/2%
1/30/82	Charming Shoppes, Inc.	1,231,850	not available
12/15/82	Crompton & Knowles Corp.	3,274,216	8%
12/31/82	Lane Bryant, Inc.	12,265,000	9 3/4%
1/02/83	Questor Corp.	13,283,180	10 1/2%
11/30/82	Swank, Inc.	7,504,743	10 1/2%
4/29/82	Western Air Line, Inc.	11,840,377	11%
11/15/82	Timex Corp	4,443,822	10 1/4%
4/01/82	Mid-American Lines, Inc.	1,001,229	not available
11/11/82	Buffalo Courier-Express Co.	1,387,052	annuities purchased

11/11/82	Buffalo Courier-Express Co.	2,907,613	annuities purchased
11/11/82	Unicon Producing Co.	2,000,000	annuities purchased
10/28/82	Superscope, Inc.	1,099,671	6.5%
4/19/82	Buxton Incorporated	1,275,332	annuities purchased
5/14/82	General Time Corp.	2,590,000	not available
10/31/82	Continental Air Lines Inc.	19,621,717	11%
6/07/82	Timex Corp	11,722,309	10 1/4%
6/01/82	Dentsply Int'l, Inc.	11,315,760	annuities purchased
10/31/82	Texas Int'l Airlines	2,141,093	annuities purchased
6/14/82	Gateway Transportation Co., Inc.	3,067,494	not available
6/30/82	Industrial Service Centers	1,061,747	10 1/4%
9/30/82	Seabrook Foods, Inc.	2,589,508	annuities purchased
9/30/82	CMI Corp. & Subsidiaries	1,957,327	annuities purchased
6/30/82	Triangle PWC, Inc.	7,803,000	not available
9/13/82	Gotaas-Larsen, Ltd.	2,092,179	12 3/4%
6/28/82	Lavino Shipping Co.	1,173,373	11%
9/04/82	Illinois-California Express	3,998,274	not available
7/08/82	Timex Corp	5,261,206	10 1/4%
9/02/82	WDS, Inc & ITS Affil.	1,583,684	not available
	Total	291,152,118	

*Category 1 = Spinoff

Category 2 = Successor Defined Benefit Plan

Category 3 = Successor Defined Contribution Plan

Category 4 = No Successor Plan

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

[illegible] 2

Mr. Francis X. Lilly
Deputy Solicitor
Department of Labor
200 Constitution Avenue, NW
Room #S-2002
Washington, DC 20210

Dear Mr. Lilly:

This letter will serve to confirm the telephone conversation David M. Walker, my Deputy Executive Director for Insurance Operations and Systems Management, had with Mr. Winborne and you regarding the AMAX settlement, which followed our meeting in Buc Chapoton's office on December 14, 1983.

As Mr. Walker reported, the agreement with AMAX incorporates the language we agreed on in our December 14 meeting to the effect that the "agreement shall not be deemed to be a determination as to whether or not there exists a plan termination under ERISA." In addition, the implementation of the agreement, including the issuance of a Notice of Sufficiency, will be subject to AMAX obtaining a favorable determination letter from the Internal Revenue Service and their being no legislation in the interim which would serve to ban the proposed transaction. The agreement has an expiration date of September 15, 1984.

I enclose a copy of the executed agreement for your files.

Sincerely yours,

Ed Jones

Edwin M. Jones
Executive Director

Enclosure

cc: Mr. S. Allen Winborne
Mr. John E. Chapoton

AGREEMENT

AGREEMENT, dated as of December 20, 1983, between AMAX Inc. (the "Company") and the PENSION BENEFIT GUARANTY CORPORATION (the "PBGC"),

WITNESSETH:

WHEREAS, on August 9, 1983, the Company filed with the PBGC a Notice of Intent to Terminate the AMAX Retirement Plan for Salaried Employees (the "Plan"); and

WHEREAS, the PBGC has raised certain issues as to whether, as originally structured, the proposed termination of the Plan should be treated as a termination entitling the Company to a reversion under Section 4044(d) of the Employee Retirement Income Security Act of 1974 ("ERISA"); and

WHEREAS, the Company has expressed to the PBGC its strong view that the proposed termination of the Plan is a termination entitling the Company to such reversion; and

WHEREAS, the disagreement between the Company and the PBGC will likely result in litigation imminently if a compromise is not reached; and

WHEREAS, the PBGC and the Company desire to avoid such litigation; and

WHEREAS, such litigation can be avoided if the Company agrees to certain modifications to the July 1, 1983 AMAX Retirement Plan for Salaried Employees (the "1983 Plan") and to certain other conditions; and

WHEREAS, based on bids the Company has received from insurance companies, the assets of $128 million transferred to the 1983 Plan from the Plan are approximately $62 million in excess of the amount required to purchase guaranteed annuities to provide all benefits accrued as of August 8, 1983 under the Plan which were transferred to the 1983 Plan plus all benefits accrued under the 1983 Plan from August 8, 1983 to August 19, 1983 (the "Accrued Benefits"); and

WHEREAS, the Company is willing to commit to not seek a reversion of this excess for at least five years; and

WHEREAS, the Company has amended the Plan and the 1983 Plan to provide benefit increases to all members as of July 1, 1983, subject to the receipt of all necessary governmental approvals of the termination of the Plan and to the distribution of the Plan's assets in connection therewith; and

WHEREAS, the Company is the plan administrator within the meaning of ERISA of the Plan and the 1983 Plan;

NOW THEREFORE, in consideration of the premises and of the commitments made hereunder, the parties hereto hereby agree as follows:

1. The Company has no present intention to terminate the 1983 Plan at any time. In any event, the Company will not terminate or partition the 1983 Plan nor seek a reversion of assets from the 1983 Plan prior to July 1, 1988 without the approval of the PBGC.

2. In order to avoid unduly reducing the amount by which the assets of the 1983 Plan exceeds the present value of accrued benefits thereunder:

(a) The Company will cause the 1983 Plan to purchase guaranteed annuities from an insurance company to provide all of the Accrued Benefits; and

(b) The Company guarantees that as of the first day of each plan year through the plan year commencing January 1, 1988, the assets of the 1983 Plan will exceed by at least $10 million the present value of vested and non-vested accrued benefits calculated as required (as of the date of this Agreement) for purposes of Item 6 of Schedule B to Form 5500, excluding the value of any insurance contracts purchased pursuant to paragraph 2(a) above and the related benefits. On or before the date the Form 5500 (or any successor thereto) is filed for each such plan year the Company shall make a contribution to the 1983 Plan equal to the amount, if any, by which the value of the assets of the 1983 Plan as of the first day of the applicable plan year less the present value of the accrued benefits described above as of such date (excluding the value of any insurance contracts purchased pursuant to paragraph 2(a) above and the related benefits) is less than $10 million. In addition, the Company shall make the contribution for the plan year required by Section 412 of the Internal Revenue Code of 1954, as amended.

3. The Company will not seek a funding waiver from the Internal Revenue Service with respect to the 1983 Plan for any plan year prior to the plan year commencing January 1, 1989.

4. The Company will amend the 1983 Plan to provide that all the Accrued Benefits are fully vested. Such amendment will

be made no later than 30 days following receipt of the Notice of Sufficiency with respect to the Plan pursuant to paragraph 6 hereof and will be effective as of July 1, 1983.

5. This Agreement shall not be deemed to be a determination as to whether or not there exists a plan termination under ERISA.

6. The PBGC will issue a Notice of Sufficiency with respect to the Plan within ten business days after receiving written notice from the Company confirming the issuance by the Internal Revenue Service of a determination letter to the effect that the termination of the Plan will not adversely affect its qualification under Section 401(a) of the Internal Revenue Code of 1954, as amended. The Company will give such written notice within 10 days of the receipt of such determination letter and will provide as part of such notice (i) a copy of such determination letter, (ii) a current bid from an insurance company stating the amount required to purchase guaranteed annuities as of the proposed distribution date to provide all benefits payable under the Plan, (iii) a certificate, signed by the Company, stating that the assets of the Plan are more than sufficient to purchase said annuities,

and that as of the date of the most recent valuation of the assets of the 1983 Plan such assets are equal to $128 million, adjusted (plus or minus) for investment results with respect to such assets since August 8, 1983 and less benefits and reasonable administrative expenses paid from such assets since that date. The Notice of Sufficiency shall authorize the distribution of the assets of the Plan in accordance with Section 4044 of ERISA.

7. The Company will not withdraw its request for a determination letter without the the approval of the PBGC, unless additional terms and conditions are required by the Internal Revenue Service which impose substantial burdens that are not acceptable to the Company, in which event the approval of the PBGC shall not be unreasonably withheld.

8. The parties to this Agreement shall have no obligations hereunder:

(a) Unless the Company receives a favorable determination letter from the Internal Revenue Service to the effect that the termination of the Plan will not adversely affect the qualification of the Plan under Section 401 of the Internal Revenue Code of 1954, as amended; or

(b) If legislation (or a resolution) has been enacted prior to the distribution of assets from the Plan in connection with the termination thereof which would cause such distribution to be a violation of law.

---

9. Unless a Notice of Sufficiency has been issued with respect to the Plan pursuant to paragraph 6 hereof prior to September 15, 1984, or prior to such later date as may be mutually agreed upon by the parties hereto, this Agreement shall terminate and be of no further force and effect and the Notice of Intent to Terminate the Plan shall be null and void and shall be deemed withdrawn.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their duly authorized officers as of the date first above written.

AMAX INC.

By David George Ball
Senior Vice President & Secretary

PENSION BENEFIT GUARANTY CORPORATION

By Edwin M. Jones
Executive Director

U.S. Department of Labor

Labor-Management Services Administration
Washington, D.C. 20216

Reply to the Attention of:

DEC 14 1983

MEMORANDUM FOR: KEN YEDNOCK
Chief, Projects Branch
Internal Revenue Service

FROM: ALAN D. LEBOWITZ
Acting Administrator
Pension and Welfare Benefit Programs

SUBJECT: Request for Information

Pursuant to section 6103(l)(2) of the Internal Revenue Code and the letter to the Commissioner of the Internal Revenue Service from me dated November 28, 1983, I am requesting release of copies of pertinent documents in the National Office relating to plan terminations in 1983 affecting Hooker Chemical, Occidental Petroleum and City Services that the Service determines are or may be necessary to the Department in the administration of Title I of the Employee Retirement Income Security Act of 1974 (ERISA), as provided in regulations promulgated by the Internal Revenue Service on September 7, 1983 (48 Fed. Reg. 40376), to the following persons: David Rood, Assistant Chief, Division of Fiduciary Interpretations and Regulations, Office of Fiduciary Standards, Pension and Welfare Benefit Programs; William Flanigan, Staff Attorney, Plan Benefits Security Division, Office of the Solicitor.

I have been delegated authority to request this information on behalf of the Department of Labor. These authorized employees will present this letter when requesting to review the information. All tax return information obtained pursuant to this letter will be safeguarded in accordance with established procedures. This information is needed for purposes of administrating provisions of Title 1 of ERISA.

Internal Revenue Service
Department of the Treasury

Assistant Commissioner
(Employee Plans and
Exempt Organizations)

Washington, DC 20224

[illegible]

Mr. Edwin M. Jones
Executive Director
Pension Benefit Guaranty Corporation
2020 K Street, N.W.
Washington, DC 20006

Dear Ed:

Increasing attention has been focused in recent months on the issue of defined benefit plans terminating with surplus assets, where the surplus reverts to the employer. Under the Code, an employer is allowed to receive surplus assets from a terminated plan upon the satisfaction of all liabilities provided the excess is due to actuarial error. However, in some situations there are serious questions regarding the techniques being used to extract assets from plans. Two of the questionable techniques may be called the termination/reestablishment technique and the spinoff/termination technique.

Under the termination/reestablishment technique, an employer terminates an overfunded plan and recovers all excess assets. The employer then establishes a new defined benefit plan (perhaps identical to the terminated plan) for the affected participants.

The spinoff/termination technique may be exemplified by the following example. An employer splits its overfunded plan into two plans, one covering active employees and the other covering retirees. The employer then terminates the plan for retired employees and recovers the excess assets.

The principal affect of both techniques is that the employer is able to obtain plan assets that would not otherwise have been available while continuing a qualified defined benefit plan.

The techniques described present the possibility for serious abuses. The Service has been concerned about these abuses and has been studying the situation and the issues involved. In a recent meeting of the IRS-Treasury Policy Committee attended by the Commissioner, the Assistant and Deputy Assistant Secretaries for Tax Policy of Treasury, the Associate Chief Counsel (Technical) for the IRS and me, a decision was reached on the Internal Revenue Service policy in this area and the courses of action that are to be taken in an attempt to prevent the abusive recovery of excess assets.

The first approach involves application of the substance-over-form doctrine. Under this approach it is recognized that although each step in the process of recovering excess assets is permissible when considered independently, the substance of the transaction is that assets have been removed from an ongoing plan in violation of the Code. Thus, the substance of the transaction will be the primary determinant of the permissibility of the series of steps, not the validity of the formally independent steps. This approach may, in appropriate circumstances, also be applied to situations involving underfunded plans and the spinoff/termination technique in which the accrued benefits of participants are reduced.

The second approach to be used is called the actuarial error theory. This approach would apply only to the spinoff/termination technique. Under this approach, it is maintained that the surplus assets did not arise from actuarial error but from the spinoff of the plan. Thus, the employer would be precluded from obtaining the surplus assets.

Proposed regulations will be developed and issued as soon as possible which will present much more detail concerning the two approaches. However, the two approaches will be implemented immediately.

Sincerely,

S. Allen Winborne

PBGC Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

MEMORANDUM FOR THE HONORABLE RAYMOND J. DONOVAN
CHAIRMAN, BOARD OF DIRECTORS

SUBJECT: ERISA Policy Board Meeting and
AMAX International Situation

On December 8 the ERISA Policy Board met and discussed the following two matters:

1. The IRS letter of December 7, 1983 from Assistant Commissioner Winborne to Mr. Jones, (copy attached).

2. The factual situation with respect to the request of AMAX International pending with the PBGC, for issuance of a Notice of Sufficiency to AMAX with respect to the termination of its salaried retirement plan in a "spin-off/termination" scenario concurrently with the establishment of a substantially similar defined benefit plan for active employees.

Background on 1.

With respect to 1., the IRS-Treasury Department has now adopted the position that the termination of an overfunded defined benefit plan accompanied by the reestablishment of the substantially similar defined benefit plan, does not amount to a plan termination. Therefore any recovery of assets would be a violation of the Code because the assets would be removed from an "ongoing plan" and would disqualify the plan. This approach is called by the IRS the "substance over form" approach.

Also with respect to 1., the IRS-Treasury has concluded that when an employer splits its underfunded plan into two plans, one covering active employees and the other covering retirees, and the employer then allocates minimum permissible assets to the actives plan and terminates the plan for retired employees and recovers the excess assets, the excess assets are not properly attributable to an "actuarial error" (which would be recoverable) but rather are attributable to the spin-off and are therefore not properly recoverable by the employer. The result would be disqualification of the plan for tax purposes. The underlying theory is the same as in the preceding situation, namely that a termination of a plan has not occurred. This approach is called by the IRS the "actuarial error" approach.

However, the Treasury cautions that it wishes to look at each situation on a facts and circumstances basis with a view to determining whether the substance of the transaction, as distinct from the form of the transaction, amounts to the removal of assets from an ongoing plan.

Discussion of 2.

With respect to 2., the AMAX International factual situation, the IRS-Treasury representatives were not prepared to make a specific commitment without reviewing all the facts and circumstances. However, on the basis of the known facts, the AMAX-proposed spin-off/termination technique would run afoul of both the IRS substance-over-form doctrine and the actuarial-[illegible] theory.

The AMAX-type situation and other defined benefit plan termination situations were discussed earlier this year on [illegible] various occasions among representatives of Treasury, IRS, DOL and the PBGC. Following those occasions, the reversion of [illegible] approximately $500 million of plan assets to employers since January 1, 1980 in plan termination cases has received wide publicity, as you know. Another approximately $1 billion in excess assets could revert to plan sponsors in cases presently before the PBGC. In the AMAX situation, I am advised that AMAX officials have met and discussed the matter with Treasury Department officials.

At the PBGC level, AMAX has offered to make considerable concessions from the traditional pattern that is typically followed in a termination case involving the reversion of [illegible] assets to an employer. Under the AMAX proposal approximately [illegible] million of assets which might otherwise revert to AMAX [illegible] maintained under the ongoing plan of AMAX covering [illegible] As a result, the reversion would thus be reduced from about [illegible] million to $100 million. AMAX would also commit to maintain a [illegible] million funding margin for five years. AMAX is prepared to [illegible] all employees with respect to all accrued benefits (whether or not they would be vested under terms of the plan) and is prepared to buy annuities from Metropolitan Life Insurance Company that will fully protect the participants with respect to their accrued benefits as of the date of termination. AMAX has also announced benefit improvements in the neighborhood of 10%. AMAX claims that its proposal produces a better result from both the employee side and the PBGC side than has typically resulted in cases where there is complete termination of the defined benefit plan followed by the concurrent establishment of a similar defined benefit plan. The practical result is better, they argue, [illegible] because some $62 million will be held in the ongoing plan as future protection to the PBGC should company operations subsequently turn sour, and because of AMAX's $10 million commitment. Employees will be somewhat better off because they will be given some additional benefits.

Such a practical result deserved consideration, in my view since the long-standing position of Treasury, IRS and DOL has been to recognize a complete termination of a defined benefit plan followed by the concurrent establishment of a similar defined benefit plan. The PBGC questioned that approach in December 1982 and January 1983, but was then advised that neither DOL nor the IRS had any questions about allowing such reversions.

BEST AVAILABLE COPY

Accordingly, PBGC lifted a temporary hold on processing that type of case and resumed to processing them in the usual way that has been followed for years.

When the AMAX spin-off/termination technique blossomed during the 1st half of 1983 in the Stroh, AMAX and other cases, I became concerned that recognition by the PBGC of the existence of the "spin-off/termination technique" would expose the PBGC to substantial liabilities in the case of underfunded plans because under that technique an underfunded plan could split its plan into a retired lives plan and an actives plan, and drop the underfunded liabilities under the retired lives portion of the plan onto the PBGC. If this became widespread, the resultant losses to the PBGC could be huge. This technique had been initiated earlier in the McLouth Steel Company case and the PBGC took the view that use of such technique was an ~~abuse of the~~ insurance system and that no termination of the plan had occurred. That matter went into litigation. We are now in the process of working out a settlement which I believe will reasonably protect the PBGC.

Latest Development

By July 1983 the pressure for allowing reversion of excess assets of employers in spin-off/termination cases became substantial and an ERISA Policy Board meeting was convened by me. At that meeting the Treasury/IRS concluded that they should review the situation. Their review has taken many months, as you may recall from my discussions with you in September about this matter. (My memorandum to Mr. Aubry dated September 14, 1983, an earlier memorandum of mine to Mr. Lilly dated July 29, 1983 and other memoranda relating to the intended PBGC Board consideration of this matter, are pertinent and are attached.)

The PBGC's viewpoint, has been that there is very little, if any, legal basis for concluding (but for the IRS prior position in this matter) that a plan termination recognizable under Title IV has occurred under either the spin-off/termination arrangement, or the straight plan termination/plan reestablishment technique. However, from a practical point of view it can be contended that it is better to allow leeway to employers in this area to recover excess assets (which are arising in so many cases under existing circumstances because of the high interest rates which insurance companies are assuming in pricing buy-out contracts) and to allow them to reestablish another defined benefit plan, because the PBGC may lose less premium revenue than if large numbers of defined benefit plans were to be terminated and changed into defined contribution plans (which appears to be permissible under ERISA Section (4041 (f)).

Furthermore, from a practical point of view the PBGC has recognized that the practice of allowing companies to terminate their defined benefit plans and reestablish substantially similar plans concurrently with the termination has been allowed for years by the IRS and by the PBGC, and no question has ever been raised about that practice by the IRS, PBGC or DOL. A change in that procedure may have a substantial impact on employers and on the exercise of their options with respect to the maintenance of defined benefit plans.

[redacted] of allowing employers to "terminate" a plan in form (by appropriate Board resolutions and other paper work) and immediately establish the same or similar plan, and to recognize these two steps as amounting to a plan termination permitting a reversion of excess assets to the employer, [redacted] and [redacted] My view is the same with respect to the spin-off/ reestablishment technique.

Decision Needed

With particular regard to AMAX, the PBGC is obligated by law to issue, within ninety days of its receipt of a Notice of Intent to Terminate a plan, a Notice of Sufficiency that AMAX plan assets are sufficient under Title IV to pay covered benefits. [redacted] the [redacted] notifying the employer that it is unable to find a sufficiency of plan assets, or obtain a written extension of that period by agreement, [redacted] since its assets clearly are sufficient to cover Title IV benefits.

AMAX has given the PBGC two extensions of the ninety-day period. [redacted] AMAX has indicated that it will not give us another extension. If that position is maintained, the PBGC has two alternatives:

1. Advise AMAX that it does not recognize the spin-off termination arrangement as constituting a valid termination recognizable under Title IV and return the Notice of Intent to Terminate to AMAX. AMAX might then bring some type of court action, such as mandamus action, to force us to issue a · Sufficiency letter.

2. Complete negotiations along the lines that have been started, even though the substance of the negotiated settlement would involve a recognition of plan termination, contrary to the position of the IRS and contrary to the concept of a valid

3. [redacted] in light of the new IRS position and pending policy consideration of this matter by the PBGC Board and the Administration. The AMAX people have already stated they would not give the PBGC another extension, particularly in light of the fact that AMAX wants to obtain the excess by the end of the

year for tax reasons and also is concerned about the possible introduction and enactment of legislation in early 1984 that would prevent asset reversions from occurring on termination of a defined benefit plan.

Pending further advice from you on a policy basis, it would appear that logical steps for PBGC to follow would be:

First, to seek an extension of time within which the PBGC may act, recognizing that the extension period if agreed to at all will be short;

Second, failing that, to serve a rejection notice on AMAX recognizing that a lawsuit might then be brought against the PBGC;

Third, to proceed with the settlement along the lines that have been proposed by AMAX to date strictly for PBGC Title IV purposes, leaving unclear what would happen at the IRS level in recognition of the fact that the IRS has advised that each case will be assessed by it on a facts and circumstance basis, and it is conceivable that the IRS would eventually conclude that the proposed settlement arrangement is justifiable and is not a case that should be treated as a "non-termination."

So far as I know the Administration, as distinct from any one Department or Agency, has never focussed on this matter. The presentation of the matter to the Board was awaiting advice from the Treasury-IRS (as indicated by the attached memoranda and proposed agenda items) as to how it was going to conclude on this matter in light of all existing facts and circumstances, including the Congressional inquiry into this matter. I understand you are proceeding with respect to Board and Administration review of this matter.

Your advice on how the PBGC should proceed with AMAX next week would be appreciated.

Edwin M. Jones
Executive Director

Attachments

cc: Mr. Lilly

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

DEC - 1 1983

MEMORANDUM FOR ERISA POLICY BOARD MEMBERS

SUBJECT: December 8 Meeting

I am requesting a meeting of the ERISA Policy Board to be held on December 8 at 2 p.m. in the Board Room at the PBGC, for the purpose of achieving interagency coordination on the PBGC's recognition or non-recognition of the termination of "retired lives" plans in general and of the termination of one plan in particular. This issue has previously been addressed by the ERISA Policy Board, and the matter has been under advisement by the Treasury Department and the Internal Revenue Service since July of 1983.

We have a number of spin-off termination cases pending which total over $175 million in potential asset reversions and represent approximately 58% of the current plan assets for the involved plans. Many of these cases are nearing the end of the statutory processing period provided to the PBGC in issuing Notices of Sufficiency.

One case in particular, an agreement to extend the processing period has been reached in order to allow important interagency coordination. In this case, a number of commitments will be made. In economic effect they would produce the same result as a complete termination of a plan, concurrently with the institution of a new plan providing for pension benefits based on future accruing service only and, in addition, result in retaining plan assets at a level considerably above the required minimum levels. They would tend to protect the PBGC and plan participants and beneficiaries from a risk standpoint. This case involves a potential reversion of over $100 million to the plan sponsor out of an approximately $300 million in total plan assets. The basic elements of the commitment by this company are reflected in Attachment A to this letter. A PBGC decision in this case must be made promptly.

As we all know, the House Select Committee on Aging recently held a public hearing on the asset reversion issue. Various DOL, IRS and Treasury representatives have previously advised us in at least two cases on which interagency policy board meetings have been held that a total termination accompanied by the concurrent institution of a new defined benefit plan does not represent any problems for their respective agencies from a fiduciary or qualified plan standpoint. Accordingly, the PBGC has recognized such transactions provided that they do not represent an abuse of the insurance system in our judgment. If there is any change in the views of DOL, Treasury and the IRS in this type of termination, we would like to be informed of same.

I look forward to seeing you on December 8 at 2 p.m. in the Board Room at the PBGC.

Edwin M. Jones
Executive Director

Enclosure

Attachment A

Special Commitments Proposed by One Company Terminating a Retired Lives Plan Concurrently with the Institution of Active Lives Plan

1. Fully vest all participants to the extent of all accrued benefits for members of the terminated (retired lives) and surviving (active employee lives) portions of the plan.

2. Purchase annuity contracts for all benefits noted in A above for both the terminated and surviving portions of the plan. The same would be required in a regular plan termination.

3. Divide the resulting excess assets between the terminated and surviving portions of the plan, in a way which would result in leaving a significant excess in the surviving portion. This would provide a sizeable cushion to the PBGC and the plan participants and beneficiaries relative to the surviving plan as of the moment of termination.

4. Commit to maintaining a level of plan assets in the surviving active lives plan which is in excess the actuarially calculated plan liabilities for a period of five years after the spin-off termination with a minimum excess amount to be negotiated.

E. Agree not to seek to terminate or partially terminate the surviving plan for a period of five years.

F. Agree not to seek a minimum contribution waiver from the IRS for the surviving plan for a period of five years.

U.S. Department of Labor

Labor-Management Services Administration
Washington, D.C. 20210

Reply to the Attention of

NOV 28 1983

Mr. S. Allen Winborne
Assistant Commissioner
Employee Plans and Exempt
  Organizations
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Mr. Winborne:

As you are aware, a number of issues have been raised as to whether, and under what circumstances, a defined benefit plan termination, or "spin-off" followed by a termination, resulting in the reversion of excess assets to the plan sponsor may be violative of provisions under title I of the Employee Retirement Income Security Act of 1974 (ERISA). We believe that such determinations should, to the extent possible, be made in coordination with the Internal Revenue Service's review of a plan's application for determination on termination.

In order to facilitate the Department's review of termination cases involving the reversion of assets to plan sponsors and to ensure the opportunity for timely consultations with the Service on those cases involving potential title I violations, we are requesting that the Service provide the Department with access to any information and data obtained by the Service in the course of its review and examination of termination cases involving asset reversions, to the extent such information is subject to disclosure under section 6103 of the Internal Revenue Code (the Code) and the regulations issued thereunder. At this time, we are requesting that the Service furnish to the Department information and data pertaining to those plan termination cases involving the reversion of assets to plan sponsors referred to the National Office of the Service for examination and review and any other such cases which may involve matters relating to the Department's administration and enforcement of the provisions of title I.

We believe that the requested information is necessary for the Department to carry-out its statutory functions under title I and to coordinate its administrative responsibilities thereunder with the Internal Revenue Service. Accordingly, we believe that the requested information is subject to disclosure under section 6103 of the Code and the regulations issued thereunder; specifically 26 C.F.R. §301.6103(l)(2)-3(a)(3), concerning applications for determinations on termination, and §301.6103(l)(2)-(3)(b)(1)(ii) concerning the voluntary disclosure by the Service to the Department of additional returns and return information as the Service determines are or may be necessary in the administration of title I.

Pursuant to §301.6103(l)(2)-3(a) and (b)(3)(ii), an annual written request has been made with the Commissioner of the Internal Revenue Service for the disclosures described in subsections (a) and (b) of §301.6103(l)(2)-3, including the disclosure of any information thereunder that the Service determines is or may be necessary to the Department in the administration of title I. A copy of our request is enclosed.

We appreciate your assistance in this matter. Should you have any questions concerning this request, please do not hesitate to contact me.

Sincerely,

Alan D. Lebowitz
Acting Administrator
Pension and Welfare Benefit Programs

Enclosure

cc: subject
chron
central files
w.f.
Lebowitz
LMSA/PWBP/ORPS/DPS/RDoyle/pds/11-23-83/N-4700

Pension Benefit Guaranty Corporation
2020 K Street, N.W. Washington, D.C. 20006

Edwin M. Jones
Executive Director

November 18, 1983

Honorable Francis X. Lilly
Deputy Solicitor
Department of Labor
200 Constitution Avenue, N.W.
Room S-2002
Washington, D.C. 20210

Dear Frank:

In talking with Al Lebowitz, he thought it might be desirable to send you a copy of my letter to Buck Chapoton on a matter which has been pending with the Treasury Department for many months.

This matter is one of the issues that I raised with Secretary Donovan in a meeting that I had with him in September on possible agenda items for the next meeting of the Board of Directors of the PBGC. A listing of items I discussed with him is also attached, along with a revised list which resulted from the meeting.

As you will note, Item 2 of the revised list relates to the matter being referred to in my attached letter. Item 3 covers another type of termination which I am told is also under review by the Treasury. It was concluded in September that these items needed further flushing out before presenting them to the Board, and that any such presentation should await the consideration of the issues by the Treasury's Tax Policy Committee under Buck Chapoton. Unfortunately, Buck has simply not been able to get to the matter.

I would appreciate receiving any thoughts you may have on the issues raised in the attached letter. Prior letters of mine to Buck Chapoton are also enclosed for your convenience, although I think you may already have been copied on them.

Sincerely yours,

Ed Jones

Edwin M. Jones
Executive Director

Enclosures

Draft Agenda for Meeting of Board of Directors

1. Report on Status of Corporation.

    A. Financial Operations
    B. Insurance Operations
    C. Administrative Matters
    D. Legislation

2.* Issues relating to proposed "termination" of part of a plan with respect to only retired and deferred vested participants.

    A. Loss to PBGC (insufficient cases)
    B. Excess Asset Reversion to Employer

3.* Issues Relating to Termination of Sufficient Plans when a similar successor "new" plan is created which in effect continues the "terminated" plan, in light of PBGC's standing practice not to recognize the termination of insufficient plans under similar circumstances which result in a loss to the PBGC.

4. Issues Relating to Involuntary Plan Terminations.

    A. IRS Waivers
    B. Shutdown benefits
    C. Phase-in of benefits.

        (1) Net worth
        (2) Ongoing diminution of unsecured assets available to PBGC

    D. Overall policy implications

* Pending completion of review by Tax Policy Committee at the Department of Treasury.

1st List
Discussed
with Sec.
Donovan

Draft Agenda for Meeting of Board of Directors

1. Report on Status of Corporation.

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      (1) Net worth
      (2) Ongoing diminution of unsecured assets available to PBGC

   D. Overall policy implications

5. Issues Relating to Granting of Special Withdrawal Liability Rules for Multiemployer Plans.

   A. Existence of like characteristics to construction industry
   B. Significant risk of loss to PBGC

6. Adoption of Unisex Tables by the PBGC.

7. Update on Status of Privatization within the PBGC.

   A. Sufficient cases
   B. Discussions with Private Sector

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

November 18, 1983

Honorable John E. Chapoton
Assistant Secretary for Tax Policy
Department of the Treasury
15th & Pennsylvania Avenue, NW
Room #3120
Washington, DC 20220

Dear Mr. Chapoton:

Since my letters of July 25 and October 26, 1983, there has been a significant increase in activity relative to "spin-off" termination cases in the Corporation, the media and the Congress.

We are approaching a critical stage in the handling of our pending cases of this kind. For example, one "retired lives" plan termination would result in a reversion of over $100 million to the Company out of about $300 million in total plan assets. The initial statutory PBGC processing period for this plan was to expire on November 19, 1983. We met with representatives of this Company last week and obtained their agreement to extend the November 19 deadline until December 1, 1983, in light of your Tax Policy Committee's reconsideration of this matter from the Treasury viewpoint. As a practical matter, we must decide what the PBGC's position will be by November 28 in order to finalize negotiations with the Company on settlement basis, or prepare for possible legal action should we refuse to process the termination.

In this case, the Company has offered to do the following should we decide to recognize the spin-off and resulting termination:

A. Fully vest all participants to the extent of all accrued benefits for members of the terminated (retired lives) and surviving (active employee lives) portions of the plan.

B. Purchase annuity contracts for all benefits noted in A above for both the terminated and surviving portions of the plan. The same would be required in a regular plan termination.

C. Divide the resulting excess assets between the terminated and surviving portions of the plan, in a way which would result in leaving a significant excess in the surviving portion. This would provide a sizeable cushion to the PBGC and the plan participants and beneficiaries relative to the surviving plan as of the moment of termination.

D. Commit to maintaining a level of plan assets in the surviving active lives plan which is in excess the actuarially calculated plan liabilities for a period of five years after the spin-off termination with a minimum excess amount to be negotiated.

E. Agree not to seek to terminate or partially terminate the surviving plan for a period of five years.

F. Agree not to seek a minimum contribution waiver from the IRS for the surviving plan for a period of five years.

The above commitments would tend to protect the PBGC from a risk standpoint. The economic effects for the employers, the employees and the PBGC would be substantially similar to the effects incident to a plan terminated in the regular way followed by the institution of a new defined benefit plan providing benefits for service accruing after the termination date. As to that type of termination, IRS, Treasury and DOL representatives have previously advised the PBGC that it presents no problems for them. However, the commitments do not directly address our basic legal concern as to whether spin-offs of this kind should be recognized as qualified terminations under Title IV, in light of the IRS conflicting regulation on spin-offs. I note, also, that in many cases the possibility of negotiating protective commitments may not exist.

We do not want to proceed on a basis which constitutes a material difference on a policy matter between federal agencies, but time is running out. We urgently need to know the Treasury Department's position in this matter to make a coordinated and prudent decision, and request that you advise us of same by November 28. I am also in contact with DOL.

Sincerely yours,

Edwin M. Jones

Edwin M. Jones
Executive Director

cc: Francis X. Lilly
Alan D. Lebowitz

October 26, 1983

Mr. John E. Chapoton
Assistant Secretary for Tax Policy
Department of Treasury
Room 3120
15th & Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. Chapoton:

We now have four pending cases involving the attempted spin-off of a combined defined benefit plan into two plans, one covering retired employees and the other covering active employees. We are withholding final processing of these cases pending your advice as to the Treasury Department's position on the concerns expressed in my letter of July 25, 1983, to you.

Our General Counsel advises me that the present position of the IRS as to "spin-offs" is such that it would likely prevent us from sustaining our position that this type of spin-off does not constitute a "plan" which, when "terminated" after a moment of existence, was meant to be processed as a termination under Title IV. Even if its momentary existence were to be recognized, it would be a partial termination at best, which the PBGC has never recognized as a termination under Title IV.

On the other hand, our General Counsel advises me that, if it were not for the present position of the IRS, there is a reasonable likelihood that the PBGC in a contested case would prevail in its position as above stated.

You have advised me that this matter is under policy consideration by the Treasury Department, and we have been withholding action on these cases pending your further advice. However, the pressure on us to process these cases is substantial. We do not think it appropriate to continue in this posture much longer, and we urgently request your response to our July 25, 1983, letter.

Sincerely yours,

Edwin M. Jones
Executive Director

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

July 25, 1983

Mr. John E. Chapoton
Assistant Secretary for Tax Policy
Department of Treasury
Room 3120
15th & Pennsylvania Avenue, NW
Washington, DC 20220

Re: Creation of "Plan" for Retired Lives Followed by Proposed Termination

Dear Mr. Chapoton:

At our recent meeting on the above subject, I expressed PBGC's view that the IRS is incorrect in its position that two separate plans are created when there is a division of a plan into two parts - one for active lives and one for inactive lives - coupled with the intent to terminate the inactive lives portion under circumstances discussed herein. The issue arises in cases (1) where the plan has excess assets and the employer proposes to recoup all excess assets through termination of the inactive lives portion and (2) where PBGC guarantees are sought with respect to the termination of the inactive lives portion. I understand that you have this matter under consideration, and I trust that this letter will assist you in your determination and lead you to the conclusion that the PBGC position is the correct one.

The IRS position fails to recognize the realities of these situations which are designed to avoid specific requirements in the law and in the case of insufficient plans to dump liabilities on the PBGC. Over the years IRS has urged its step transaction theory on the courts, and has been largely successful in developing a body of case law which holds that steps taken by taxpayers will be disregarded when failure to cut through formalism will result in avoidance of tax liability not intended by the law. We submit that IRS should apply the logic of the step transaction doctrine not only where there is tax avoidance but where the employer attempts to obtain excess assets or PBGC guarantees by structuring a transaction as a plan termination when in reality the plan is continuing.

Consider the reality of the purported creation of a separate plan for retired lives. By "spinning off" active lives, all that the employer has done is execute another plan document with the same provisions as the existing plan document but made applicable only to active lives. Presumably, the employer also made a formal transfer of assets and liabilities attributable to active lives. At this point, any resemblance to the existence of a separate plan for retired lives ceases. What exists are two plan documents and funds purportedly applicable to separate groups. But the retired lives "division" has none of the indicia of a separate plan. It is to terminate immediately. It is a creature fleetingly created, intended to smooth the path to a termination which, without this creature, would not be recognized by PBGC since under Title IV of ERISA ~~a "partial" termination~~ is not an insurable event. Contributions will never be made to the so-called "retired lives plan." It will never cover any active participants. This so-called separate plan is completely lacking in permanence. 1/ The bottom line is that the arrangement amounts to no more than the continuance of payment of pension benefits to retirees and provision for benefits for other non-active lives, with the funding of all of these benefits through the purchase of annuities in an ongoing plan. This is the reality of the situation when one cuts through the trappings. In a sufficient plan with excess assets, annuities are purchased to the extent of the full accrued benefits of the non-active lives. In the case of an insufficient plan, the benefits payable under the plan prior to the "carve-out" arrangement would be reduced to the level of PBGC guaranteed benefits if PBGC were to accept the termination of the "carved-out" plan.

Where there is a sale of a business and the buyer assumes only the active lives portion, PBGC's liabilities could be increased even further if the buyer is weak financially, plan liabilities increase without compensating funding and there is an eventual termination of the active lives part. If the buyer is strong financially, the carve-out arrangement, if permitted, would relieve the buyer of the funding of the non-active lives portion at the expense of the PBGC and its premium payers. We cannot envision this result as one intended by Congress. We think the potential abuse of the insurance system in this case and in many others is apparent. We would hope that from a policy viewpoint, you would be able to reach the same conclusion, and help prevent the abuse. Our General Counsel is of the strong opinion that our case is

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1/ Indeed, we suspect that practitioners attempt to avoid the permanence issue by spinning off active lives to the "new" plan. If the steps were reversed, *i.e.*, a spin-off of non-active lives followed by proposed termination, the potential failure to satisfy the permanency requirements of the Treasury Regulations would be in full view.

substantially weakened if IRS continues to maintain that the carve-out arrangement results in there being two separate plans.

Finally, at our meeting there was a discussion of the "Lubick letter," involving a case in which the Treasury Department and PBGC agreed that certain action did not give rise to a separate plan. As indicated in my letter of June 30, 1983, to Allen Winborne (copy enclosed) we feel that the reasoning in the "Lubick letter" applies equally in the cases discussed above.

I would appreciate very much hearing further from you this week if at all possible. We are actively engaged in litigation in an insufficient plan case, and a court deadline is imminent.

Thank you again for your consideration.

Sincerely yours,

Edwin M. Jones
Executive Director

Enclosure

PBGC
Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

Edwin M. Jones
Executive Director

September 26, 1983

MEMORANDUM FOR: Jeffrey Lewis
Legislative Liaison Officer
U.S. Department of labor

Subject: Statement of John J. Walsh

On page three the statement is made that excess assets in a plan can lawfully revert to the plan sponsor upon complete termination. I suggest that the word "can" be changed to "may", as in Section 4044(d)(1), and that other words "the distribution does not contravene any provision of law" be added.

Mr. Walsh's comments relate to Title IV which the PBGC is charged with implementing. The DOL may be concluding that reversions are legal under Title I, but our position, which has been fully discussed with the DOL representatives on a number of occasions, is that a "termination" does not occur in situations where the terminated "plan" is a "plan" that has been created only for participants who are retired at the time of its creation by a "spin-off," and another "plan" is continued which covers only active employees. The PBGC has also raised questions as to whether there is a "termination" under Title IV when a plan is "terminated" by a Board resolution and another similar or identical plan is simultaneously placed into effect by the Board.

We have been advised that the DOL has no fiduciary question with respect to these matters, but the PBGC is not yet recognizing a terminated "spun-off" plan for retired employees as a termination under Title IV, either in the context of an excess situation or in the context of a deficit situation. The PBGC is also not recognizing the asserted termination of an underfunded plan where a similar or identical plan is being established when the termination produces a loss for the PBGC.

On page four you refer to a termination decision as a business decision of the employer, and that it is a fiduciary decision and that the situation is not changed when the corporate official who is deciding to terminate the plan is a fiduciary of the plan, presumably the plan administrator. I suggest that there is a distinction between the act of deciding to terminate, which is a business decision, and any acts of the plan administrator which are required of him as a fiduciary in the light of the termination. The plan administrator has a fiduciary obligation to act solely in the interest of the participants, and the PBGC has taken the position in the Braniff reorganization that the company officials acting as plan administrator are independently liable as fiduciary to seek collateral for an IRS waived contribution when other lenders have secured collateral for their loans. Our present position is that we will continue to assert this liability, and we would prefer that your statements should not be so broad, as they now seem to be, as to be capable of contrary interpretation. The same position may be taken by us in non-reorganization cases, at least where the termination results in a loss to the PBGC.

In short, the fiduciary would appear to have a separate responsibility to determine whether he should take any action either to stop the termination of the plan or to stop the reversion of any portion of the excess assets in a particular case. The latter decision is a fiduciary matter.

Thus, at the top of page five you might consider adding a comment to the effect that the question as to whether a fiduciary should seek to take a particular action with respect to the excess assets is a fiduciary question.

On page six you deal implicitly with ERISA rules as a "factual" termination. I would prefer that you limit your statement to Title I interpretation. I do not agree that compliance with Title IV rules as to termination should be or is a factual termination. Facts are, of course, important in deciding any particular case, but the determination as to compliance in my view is a legal determination and not a factual one.

As noted above, the real question in the various cases presented to us is whether a "termination" occurs. I would prefer that your statements not be broad enough to enable PBGC's responsibility to be swept within Mr. Walsh's statements.

On page seven you include a sentence at the end of the first paragraph regarding exposure to the PBGC. I would prefer that you not include any reference to the PBGC, and that the sentence beginning with "In addition" be deleted.

As I believe you know, this entire matter is under reconsideration by the Treasury Department. The PBGC's position has been expressed in my letter of July 25, 1983 to Mr. Chapoton, a copy of which is attached. It occurs to me that a fair question exists as to whether any testimony should be given by the Department of Labor representatives or by the IRS until a decision on this matter is reached by the Board of Directors of the PBGC, in the event of a final difference of opinion between the various government agencies.

A marked copy of your talk reflects comments by one of our legal staff.

Edwin M. Jones

Edwin M. Jones
Executive Director

Enclosures
cc: Mr. John J. Walsh

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

July 25, 1983

Mr. John E. Chapoton
Assistant Secretary for Tax Policy
Department of Treasury
Room 3120
15th & Pennsylvania Avenue, NW
Washington, DC 20220

Re: Creation of "Plan" for Retired Lives Followed by Proposed Termination

Dear Mr. Chapoton:

At our recent meeting on the above subject, I expressed PBGC's view that the IRS is incorrect in its position that two separate plans are created when there is a division of a plan into two parts - one for active lives and one for inactive lives - coupled with the intent to terminate the inactive lives portion under circumstances discussed herein. The issue arises in cases (1) where the plan has excess assets and the employer proposes to recoup all excess assets through termination of the inactive lives portion and (2) where PBGC guarantees are sought with respect to the termination of the inactive lives portion. I understand that you have this matter under consideration, and I trust that this letter will assist you in your determination and lead you to the conclusion that the PBGC position is the correct one.

The IRS position fails to recognize the realities of these situations which are designed to avoid specific requirements in the law and in the case of insufficient plans to dump liabilities on the PBGC. Over the years IRS has urged its step transaction theory on the courts, and has been largely successful in developing a body of case law which holds that steps taken by taxpayers will be disregarded when failure to cut through formalism will result in avoidance of tax liability not intended by the law. We submit that IRS should apply the logic of the step transaction doctrine not only where there is tax avoidance but where the employer attempts to obtain excess assets or PBGC guarantees by structuring a transaction as a plan termination when in reality the plan is continuing.

Consider the reality of the purported creation of a separate plan for retired lives. By "spinning off" active lives, all that the employer has done is execute another plan document with the same provisions as the existing plan document but made applicable only to active lives. Presumably, the employer also made a formal transfer of assets and liabilities attributable to active lives. At this point, any resemblance to the existence of a separate plan for retired lives ceases. What exists are two plan documents and funds purportedly applicable to separate groups. But the retired lives "division" has none of the indicia of a separate plan. It is to terminate immediately. It is a creature fleetingly created, intended to smooth the path to a termination which, without this creature, would not be recognized by PBGC since under Title IV of ERISA a "partial" termination is not an insurable event. Contributions will never be made to the so-called "retired lives plan." It will never cover any active participants. This so-called separate plan is completely lacking in permanence. 1/ The bottom line is that the arrangement amounts to no more than the continuance of payment of pension benefits to retirees and provision for benefits for other non-active lives, with the funding of all of these benefits through the purchase of annuities in an ongoing plan. This is the reality of the situation when one cuts through the trappings. In a sufficient plan with excess assets, annuities are purchased to the extent of the full accrued benefits of the non-active lives. In the case of an insufficient plan, the benefits payable under the plan prior to the "carve-out" arrangement would be reduced to the level of PBGC guaranteed benefits if PBGC were to accept the termination of the "carved-out" plan.

Where there is a sale of a business and the buyer assumes only the active lives portion, PBGC's liabilities could be increased even further if the buyer is weak financially, plan liabilities increase without compensating funding and there is an eventual termination of the active lives part. If the buyer is strong financially, the carve-out arrangement, if permitted, would relieve the buyer of the funding of the non-active lives portion at the expense of the PBGC and its premium payers. We cannot envision this result as one intended by Congress. We think the potential abuse of the insurance system in this case and in many others is apparent. We would hope that from a policy viewpoint, you would be able to reach the same conclusion, and help prevent the abuse. Our General Counsel is of the strong opinion that our case is

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1/ Indeed, we suspect that practitioners attempt to avoid the permanence issue by spinning off active lives to the "new" plan. If the steps were reversed, *i.e.*, a spin-off of non-active lives followed by proposed termination, the potential failure to satisfy the permanency requirements of the Treasury Regulations would be in full view.

substantially weakened if IRS continues to maintain that the carve-out arrangement results in there being two separate plans.

Finally, at our meeting there was a discussion of the "Lubick letter," involving a case in which the Treasury Department and PBGC agreed that certain action did not give rise to a separate plan. As indicated in my letter of June 30, 1983, to Allen Winborne (copy enclosed) we feel that the reasoning in the "Lubick letter" applies equally in the cases discussed above.

I would appreciate very much hearing further from you this week if at all possible. We are actively engaged in litigation in an insufficient plan case, and a court deadline is imminent.

Thank you again for your consideration.

Sincerely yours,

Edwin M. Jones
Executive Director

Enclosure

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

Edwin M. Jones
Executive Director

September 14, 1983

MEMORANDUM FOR: Mr. Lloyd Aubry
Special Assistant and Counselor to the Assistant Secretary for Policy, Evaluation and Research
U.S. Department of Labor

Subject: Draft Agenda for Meeting of Board of Directors

Enclosed is a copy of an initial briefing book which Mr. Putt prepared for use in the scheduled meeting with Secretary Donovan. I had brought with me this copy for you, since I thought I would see you at the same time that I saw the Secretary.

I explained to the Secretary that when I originally asked for the meeting I had wanted to discuss from a policy point of view the matters raised in Items 2, 3 and 4 on the agenda, but that we could cover all agenda items if he had time.

We discussed Issues 2, 3 and 4. I told the Secretary that Items 2 and 3 are still under consideration by the Treasury Department and the Internal Revenue Service. There is a possibility of resolution along lines recommended by us, and the Secretary is of the view that we should await developments at the Treasury level before making a decision on scheduling Items 2 and 3 for a Board meeting. Depending upon what happens at the Treasury level, the Secretary would like us to work up "issues" and options under each issue.

Item 4 is one in which he expressed considerable interest, and would probably be retained on the agenda. Specific issues and options should also be developed on this point. Item 1 would remain on the agenda. Items 5, 6 and 7 were discussed with him, and his present view is that they need not be addressed by the Board.

Perhaps you and Kevin could work together in developing issues and options under Item 4, and under 2 and 3 when we hear from Treasury. With respect to 4, I have a feeling that it might be desirable to point up the general issue by discussing a particular case such as International Harvester.

Please let me have your reactions, and also your thought as to when we should have another meeting with the Board reps.

Edwin M. Jones
Executive Director

cc: Kevin W. Putt
Enclosure

Draft Agenda for Meeting of Board of Directors

1. Report on Status of Corporation.
    - A. Financial Operations
    - B. Insurance Operations
    - C. Administrative Matters
    - D. Legislation

2. Issues relating to proposed "termination" of part of a plan with respect to only retired and deferred vested participants.
    - A. Loss to PBGC (insufficient cases)
    - B. Excess Asset Reversion to Employer

3. Issues Relating to Termination of Sufficient Plans when a similar successor "new" plan is created which in effect continues the "terminated" plan, in light of PBGC's standing practice not to recognize the termination of insufficient plans under similar circumstances which result in a loss to the PBGC.

4. Issues Relating to Involuntary Plan Terminations.
    - A. IRS Waivers
    - B. Shutdown benefits
    - C. Phase-in of benefits
        - (1) Net worth
        - (2) Ongoing diminution of unsecured assets available to PBGC
    - D. Overall policy implications

5. Issues Relating to Granting of Special Withdrawal Liability Rules for Multiemployer Plans.
    - A. Existence of like characteristics to construction industry
    - B. Significant risk of loss to PBGC

~~6.~~ ~~Adoption of Unisex Tables by the~~ PBGC.

~~7.~~ ~~Update on Status of Privatization~~ within the PBGC.

~~A.~~ Sufficient cases
~~B.~~ Discussions with Private Sector

PBGC U.S. GOVERNMENT AGENCY
Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

Edwin M. Jones
Executive Director

July 29, 1983

MEMORANDUM FOR: Francis X. Lilly
Deputy Solicitor
U.S. Department of Labor

Subject: Documents Requested by Committee on Aging

In accordance with our telephone conversation on July 28, I am enclosing documents relating to the request (to be received in writing) from the Committee on Aging for factual information relating to the reversion of assets to an employer resulting from the termination of pension plans.

One document, dated July 27, 1983, sets forth the names of 114 companies which have received back over $443 million in asset reversions. As you will note, this figure comes close to approximating 25% of the total value of the assets of these plans. In addition, there is a separate sheet listing the names of five companies which have filed Notices of Termination with the PBGC which I believe may also have to be sent to comply with the Committee's request. As you will note, one case involves a reversion of $248 million, amounting to almost 50% of the plan assets.

Some of these cases involve a factual situation in which the existing pension plan is being terminated but a new one is being established to provide ongoing benefits for ongoing services. I have previously raised that situation with DOL and the IRS and was advised that DOL and IRS had no objections to reversions in this type of case. As I observed to you, I retain reservations, although it appears to our lawyers that there is at best a dubious legal basis for not recognizing terminations in this type of a situation.

Other termination cases before us at the present time involve a claimed termination of a newly created "plan" covering retired lives. I am opposed to the PBGC's accepting terminations in such cases, and have discussed this matter at length with representatives of the IRS, Treasury Department and DOL.

I would like Secretary Donovan to be aware that this information is being supplied to the Committee on Aging, in view of the substantial sums involved and the possibility of publicity regarding this matter. As you will note, the total reversions shown, if they all eventuate, will amount to $871 million, out of total plan assets of $2.1 billion.

Edwin M. Jones
Executive Director

Enclosures

JUL-27-83 16:31

REVERSION OF ASSETS GT $1000000

	PLAN SPONSOR NAME1	EVA	EVB	DIFF
1)	MID-AMERICAN LINES, INC	1,458,296	457,067	1,001,229
2)	GLOBE TICKET CO	2,663,153	1,650,836	1,012,317
3)	STP CORPORATION	2,191,632	1,160,493	1,031,139
4)	R S FLING AND PARTNERS INC	1,885,707	847,332	1,038,375
5)	CLEVELAND COCA COLA BTTLG CO	1,639,082	593,827	1,045,255
6)	OMNI SPECTRA, INC	1,527,583	477,231	1,050,352
7)	BOOTHE FINANCIAL CORP	1,605,400	551,460	1,053,940
8)	INDUSTRIAL SERVICE CENTERS	2,749,889	1,688,142	1,061,747
9)	INDUSTRIAL TOWEL AND UN CO	1,974,908	910,542	1,064,366
10)	SHEDD-BROWN, INC	1,791,465	718,356	1,073,109
11)	CHEMETRON CORP	1,778,897	703,880	1,075,017
12)	AIR CALIFORNIA	2,034,595	956,329	1,078,266
13)	PIGGLY WIGGLY OPERATORS	3,370,000	2,282,505	1,087,495
14)	WHIRLPOOL CORP	3,982,080	2,882,571	1,099,509
15)	SUPERSCOPE, INC	3,152,283	2,052,612	1,099,671
16)	OGDEN FOOD SERVICE CORP	3,919,033	2,810,033	1,109,000
17)	CHAP STICK CO	3,548,803	2,406,624	1,142,179
18)	CHROMIUM MINING & SMELTING	4,711,000	3,559,790	1,151,210
19)	MOBEX CORP	1,810,000	653,860	1,156,140
20)	LAVINO SHIPPING CO	5,220,000	4,046,627	1,173,373
21)	WILPUTTE CORP	2,680,878	1,503,942	1,176,936
22)	GOLDENBERG PLYWOOD & LUMBER	1,320,382	128,692	1,191,690
23)	DURA CONTAINERS, INC	2,088,047	895,104	1,192,943
24)	FORSYTH DENTAL INFIRMARY FOR	1,984,000	781,296	1,202,704
25)	CHARMING SHOPPES, INC	2,575,051	1,343,201	1,231,850
26)	WIMBERLY & THOMAS HARDWARE	1,972,647	732,225	1,240,422
27)	LANSING B WARNER, INCORPORATED	4,770,967	3,516,256	1,254,711
28)	VALLEY NITROGEN PRDUCERS INC	2,880,000	1,620,000	1,260,000
29)	BUXTON INCORPORATED	3,100,304	1,824,972	1,275,332
30)	PRUDENTIAL LINES, INC	2,564,631	1,284,382	1,280,249
31)	EMPIRE OF AMERICA FSA/DBA	2,305,364	986,263	1,319,101
32)	BUFFALO COURIER-EXPRESS CO	5,281,469	3,894,417	1,387,052
33)	CHROMALLOY FARM SYSTEMS, INC	3,470,004	2,082,735	1,387,269
34)	MEYER BROTHERS DRUG CO	3,131,802	1,738,885	1,392,917
35)	QUAKER STATE COCA COLA BTTLG	2,706,246	1,272,885	1,433,361
36)	BOYERTOWN CASKET CO	3,833,243	2,364,000	1,469,243
37)	CANTON CO, OF BALTIMORE	3,514,853	1,955,825	1,559,028
38)	OKC CORP	2,498,890	917,671	1,581,219
39)	WDS, INC & ITS AFFILIATES	7,533,000	5,949,316	1,583,684
40)	GRUNAU CO INC	3,118,936	1,520,935	1,598,001
41)	WHITAKER CABLE CORPORATION	4,966,102	3,365,897	1,600,205
42)	ROBERT DOLLAR CO	3,016,500	1,390,001	1,626,499
43)	HOSPITAL AFFILIATES INTERNA-	2,132,833	495,807	1,637,026
44)	BETHLEHEM GLOBE PUBLISHING CO	2,327,790	635,036	1,692,754
45)	KAHN & FELDMAN, INC	3,102,776	1,394,524	1,708,252
46)	COSMOS BROADCASTING CORP	4,298,813	2,585,497	1,713,316
47)	GORDONS TRANSPORTS, INC	2,200,630	453,027	1,747,603
48)	LONE STAR BUILDING CENTERS	3,067,536	1,303,054	1,764,482
49)	SCA CONSTRUCTION SUPPLY CO	2,022,953	202,953	1,820,000
50)	CMI CORP & SUBSIDIARIES	4,988,114	3,130,787	1,857,327

Jul-27-83 16:31

REVERSION OF ASSETS GT $1000000

	PLAN SPONSOR NAME1	EVA	EVB	DIFF
51)	RDC, INC	3,311,793	1,409,556	1,902,237
52)	MERCHANTS REFRIGERATING CO	4,105,303	2,192,507	1,912,796
53)	SHELLER-GLOBE CORP	12,275,317	10,360,437	1,914,880
54)	TRIANGLE PWC, INC	5,575,000	3,657,761	1,917,239
55)	SMITH JONES INC	3,627,783	1,709,529	1,918,254
56)	HILLS-MCCANNA CO	4,185,262	2,264,308	1,920,954
57)	MONTGOMERY ROSS FISHER INC	2,425,881	494,465	1,931,416
58)	SHARSON STEEL CORPORATION	10,770,350	8,770,677	1,999,673
59)	UNICON PRODUCING CO	3,600,000	1,600,000	2,000,000
60)	COMMONWEALTH OIL REFINING CO	7,267,000	5,238,562	2,028,438
61)	GOTAAS-LARSEN, LTD	2,469,420	377,241	2,092,179
62)	VANSANT, DUGDALE & CO, INC	2,678,726	579,539	2,099,187
63)	GLOBE TICKET CO	4,890,675	2,789,696	2,100,979
64)	IBEC,	3,778,925	1,655,682	2,123,243
65)	TEXAS INTERNATIONAL AIRLINES	6,872,996	4,731,903	2,141,093
66)	CHEMETRON CORP	8,063,829	5,889,100	2,174,729
67)	EMERSON ELECTRIC CO	3,747,151	1,562,702	2,184,449
68)	CENTRAL BANK OF DENVER	6,295,908	3,982,985	2,312,923
69)	HALLE BROTHERS CO	6,032,000	3,710,599	2,321,401
70)	PELTON CASTEEL, INC	5,381,667	2,930,270	2,451,397
71)	C H STUART INC	6,949,516	4,467,918	2,481,598
72)	GENERAL TIME CORP	10,640,000	8,050,000	2,590,000
73)	CHEMETRON CORP	10,347,594	7,700,100	2,647,494
74)	FEDDERS CORP	10,095,000	7,444,000	2,651,000
75)	SAVINGS BANK OF PUGET SOUND	5,793,666	3,122,882	2,670,784
76)	HOUDAILLE INDUSTRIES, INC	6,397,371	3,573,392	2,823,979
77)	BESSIRE & CO, INCORPORATED	5,019,799	2,172,524	2,847,275
78)	BUCKEYE INTERNATIONAL, INC	7,550,660	4,687,702	2,862,958
79)	FISCHER & PORTER CO AND	7,733,000	4,826,190	2,906,810
80)	BUFFALO COURIER-EXPRESS CO	7,003,331	4,095,718	2,907,613
81)	SECURITY PEOPLES TRUST CO	4,500,000	1,500,000	3,000,000
82)	GATEWAY TRANSPORTATION CO, INC	8,128,369	5,060,875	3,067,494
83)	SUTHERLAND LUMBER CO	6,451,696	3,235,193	3,216,503
84)	CROMPTON & KNOWLES CORP	8,531,050	5,256,834	3,274,216
85)	CHEMETRON CORP	8,356,203	4,998,800	3,357,403
86)	COOK PAINT AND VARNISH CO	5,479,676	2,004,580	3,475,096
87)	BUTCHER & SINGER, INC	5,589,935	2,083,461	3,506,474
88)	WINSTON-SALEM SAVINGS & LOAN	4,355,176	420,811	3,934,365
89)	ILLINOIS-CALIFORNIA EXPRESS	10,826,716	6,830,442	3,996,274
90)	UNION PLANTERS NATIONAL BANK	9,863,021	5,719,620	4,143,401
91)	WHITE STORES, INC	7,108,302	2,685,863	4,422,439
92)	TIMEX CORP	18,339,251	13,895,429	4,443,822
93)	EQUITABLE GENERAL INSURANCE	6,799,060	2,325,731	4,473,329
94)	BRANCH MOTOR EXPRESS CO	8,760,552	4,228,633	4,531,914
95)	BUTLER MANUFACTURING CO	4,578,793	16,051	4,562,742
96)	GINO'S INC	5,928,250	1,300,887	4,627,363
97)	THE WASHINGTON STAR CO	14,865,629	9,937,400	4,928,229
98)	TIMEX CORP	10,445,152	5,183,946	5,261,206
99)	BOBBIE BROOKS, INCORPORATED	13,560,000	7,542,000	6,018,000
100)	SWANK, INC	13,781,755	6,277,012	7,504,743

PLAN SPONSOR NAME1	EVA	EVB	DIFF
01) TRIANGLE PWC, INC	20,275,000	12,472,000	7,803,000
02) F & S OIL CO	8,620,000	622,070	7,997,930
03) HARPER & ROW PUBLISHERS INC	16,889,000	6,700,000	10,189,000
04) A G BECKER INCORPORATED	22,489,203	11,358,911	11,130,292
05) DENTSPLY INTERNATIONAL INC	24,920,000	13,604,240	11,315,760
06) TIMEX CORP	34,840,893	23,118,584	11,722,309
07) WESTERN AIR LINE, INC	56,400,000	44,559,623	11,840,377
08) BANK OF THE COMMONWEALTH	16,500,000	4,510,099	11,989,901
09) LANE BRYANT, INC	40,925,000	28,660,000	12,265,000
10) QUESTOR CORP	19,307,180	6,024,000	13,283,180
11) WESTERN AIR LINES, INC	129,900,000	112,900,000	17,000,000
12) JOHN CRANE-HOUDAILLE, INC	42,487,435	23,989,609	18,497,826
13) CONTINENTAL AIR LINES INC	65,971,880	46,350,163	19,621,717
14) M W KELLOGG CO	122,799,000	64,800,000	57,999,000
	1,131,926,667	688,900,519	443,026,148

Name	Assets	Benefits	Potential Reversion
Occidential Petroleum (4 plans)	$552M	$304M	$248M
A. M. International	$144M	$ 94M	$ 50M
Stroh Brewery	$138M	$ 57M	$ 81M
Pako Corporation	$ 8M	$ 3M	$ 5M
GAF	$136M	$ 93M	$ 44M

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

JUL 28 1983

TO: Travis Knight, Acting Department Director, IOD
William DeHarde, Acting Deputy Exec. Director, IOSA
Edwin Jones, Executive Director

FROM: Harvey Lebson, Deputy Manager, CPD HL

SUBJECT: Reversion of Excess Assets - List of House Aging Committee

Attached is a updated computer run showing plans that have terminated since 1/1/80 with a reversion to the employer of more than $1M.

The following additional information is provided on the 11 largest plans:

1. A. G. Becker	- The employer started a new plan - There were no spinoffs associated with the termination. - Attached are memoranda between IOD and LD and a letter sent to IRS.
2. Dentsply	- The employer started an ESOP - There were no spinoffs associated with the terminations.
3. Timex	- We are not aware of any new plan being started after the termination. - There were no spinoffs associated with the termination.
4&5. Western Airlines	- The employer did not start a new plan. - There was no spinoffs associated with the termination of the Pilots plan. On the other plan, there were spin-offs. However, a proportionate share of the excess assets were transferred in addition to the full accrued benefits.

6. Bank of the Commonwealth - The employer started a new plan. - There were no spinoffs associated with the termination.

7. Lane Bryant - The employer started a new plan. - There were no spinoffs associated with the termination.

8. Questor - The employer started a new plan. - There were no spinoffs associated with the termination.

9. John Crane - The employer started a new plan. - There was a spinoff of certain union employees who were excluded from the plan as a result of an amendment.

10. Continental Airlines - The employer did not start a new plan. There were no spinoffs associated with the termination.

11. Kellogg - The employer started new plans. - There were no spinoffs associated with the termination.

Attached is a list of pending cases that have potential large reversions.

EDWARD R. ROYBAL, CALIF.
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JORGE J. LAMBRINOS
STAFF DIRECTOR

U.S. House of Representatives
Select Committee on Aging
Washington, D.C. 20515
Telephone (202) 226-3375

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PAUL SCHLEGEL
MINORITY STAFF DIRECTOR

July 28, 1983

Mr. Edwin M. Jones
Executive Director
Pension Benefit Guaranty Corporation
2020 K Street, N.W.
Washington, D.C. 20006

Dear Mr. Jones:

This letter is in reference to the concerns of the Select Committee on Aging (the Committee) regarding the accelerating trend of employer terminations of "overfunded" defined benefit pension plans. In preparation for the Committee's upcoming hearing, tentatively scheduled for mid-September, the Committee requests the following information.

The Committee would like to be provided with statistical information detailing:

- o the number of defined benefit plans which have been terminated, with a sufficiency, since January 1, 1980;
- o the names as well as total assets, accrued benefits, and subsequent reversions of all defined benefit pension plans terminated with "surplus assets" of one million dollars ($1 million) or more since January 1, 1980;
- o the total amount of surplus assets which have reverted to plan sponsors since January 1, 1980, and
- o the names as well as approximate total assets, accrued benefits, and projected reversion of all pension plans with pending applications for termination and determination of sufficiency.

Thank you for your cooperation and assistance.

If you have any questions about this request, please contact Roger Thomas of the Committee staff at (202) 226-3375. Thank you for your assistance.

Sincerely,

Edward R. Roybal

Edward R. Roybal
Chairman

ERR/rsd

June 30, 1983

MEMORANDUM FOR ERISA POLICY BOARD MEMBERS

SUBJECT: MATTERS TO BE DISCUSSED AT JULY 1 MEETING

Consideration of the ERISA Policy Board is requested on the following two matters:

One matter relates to a growing concern of the PBGC with respect to proposals to amend plans in such a way that retired persons and deferred vesteds who no longer work for a company are to be covered under a separate "plan" and all actives are to remain under "another" plan. Assets in an overfunded plan are transferred to the continuing "plan" for actives in accordance with IRS regulations, and the amount of such assets transferred are just sufficient to cover all accrued liabilities at PBGC termination buy-out rates. All remaining assets are transferred to the "plan" for retired people which in some cases are in excess of the amount required to fully fund the benefits for the retired people. The company then takes the second step of terminating the retired lives "plan" and causes the "excess" assets to be paid to it. In other cases, instead of an "excess" there is a deficit and a loss would be dumped onto the PBGC if the "termination" is treated as an insurable event for Title IV purposes. In either case the essence of the transaction amounts to a termination of the portion of the plan covering retired lives while continuing the plan for active lives, thus effecting a partial termination. The PBGC has never recognized a "partial" termination as a termination for Title IV purposes. The implications of an apparent trend toward the above-mentioned kind of a partial termination have immediate and long-term significance. The PBGC would like to have the views of the Policy Board on this matter. The PBGC will very soon be required to state a position on this matter in a litigation context.

A second matter relates to the granting by the Internal Revenue Service of hardship waivers with respect to required contributions to a pension plan. Last year in waiver cases, the PBGC incurred losses in three terminations of about $46.4 million which were directly attributable to waived contributions, out of a total of $131 million losses in the three cases. The PBGC has had discussions with the Internal Revenue Service regarding the IRS requiring that a security interest be granted by a company to the plan under appropriate circumstances when a waiver is granted, so that the plan would have a better chance of collecting the waived contributions in the event of a later termination and the PBGC would incur lower losses. The IRS has questioned whether the granting of such a security interest would constitute a prohibited transaction under the existing law. The IRS may also have other concerns. The PBGC would like a Policy Board discussion of this matter.

Edwin M. Jones
Executive Director

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

June 30, 1983

S. Allen Winborne
Assistant Commissioner
for Employee Plans and
Exempt Organizations
Room 3408
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Allen:

This is in further regard to the problem we have discussed concerning Section 208 of ERISA, Section 414(l) of the Internal Revenue Code, and the regulations promulgated thereunder. Illustrative facts of an immediate case are set out in my letter to you of June 2, 1983. During our phone conversation of June 8, 1983, you and your staff asked if we could suggest a legal basis to enable you to address the policy concerns we raised. As you will recall, our concern centers on the division of a single plan which has both active and non-active lives into two separate portions, one for active employees and one for non-active participants and the subsequent termination of the non-active portion.

We appreciate your forwarding a response from your Chief Counsel's office. We believe there are certain legal issues which the response did not address, and pertinent authority, in light of which, you and the Chief Counsel's office may want to reexamine this difficult question.

We believe the reasoning set forth in Assistant Secretary Lubick's letter of January 12, 1981 to Henry Rose (copy attached) is relevant to the instant matter. Assistant Secretary Lubick addressed questions of what constitutes a spinoff in the context of a multiple employer plan which provides for the segregation and subsequent termination of portions of the plan which are attributable to a withdrawn employer.

Assistant Secretary Lubick determined that:

> "...the implementation of such a plan provision would not give rise to a separate plan. In other words, the restrictions of assets under the plan cannot be characterized as a spinoff, as described in Treas. Reg. 1.414(l). [T]here is no employer maintaining the alleged spun off 'plan' where the withdrawn employer has not undertaken the obligation to make continuing pension contributions and where the alleged 'plan'

> terminated upon its creation having received no contributions and under which no new benefits accrued."

The factors listed by Assistant Secretary Lubick in determining that the segregated portion of the multiple-employer plan was not itself a plan apply equally here. The non-active and active portions were created at the same time, and the same corporate resolutions which provided for the division of the original plan also provided for the termination of the non-active portion under Title IV of ERISA. Plainly, the sponsor of the original plan did not undertake the obligation to make continuing contributions to the non-active portion. Not only did that sponsor contemplate the essentially immediate termination of the non-active portion after its creation, but the sponsor was in bankruptcy, and expected to be liquidated; under the circumstances, there was no possiblity of further contributions to the non-active portion.

Further, the non-active portion was submitted to the PBGC four days after its creation, as a plan covered by Title IV of ERISA, to be terminated ten days later. This "plan" had received no contributions and had no accruals for benefits or vesting since its creation. The clear intent of the sponsor was to create a pro forma plan (the non-active portion) solely for the purpose of immediately terminating it.

Thus in the context of the case described to you we believe that the steps taken by the plan sponsor to create a non-active portion of the plan do not give rise to a separate plan. Therefore, those steps should not constitute a spinoff under Section 414(l).

We note that the opinion from the Chief Counsel's office identifies the described transaction as ". . . a partial termination . . . ." We too believe that the described transaction is, in fact, a partial termination. As such, it is not an insurable event under Title IV. The well settled tax law principle that one can not do in several steps that which one is prohibited from doing in a single step therefore comes into play. Accordingly, we think there is common ground for ERISA agencies to support the conclusion that no Title IV termination results from the transactions discussed here.

We appreciate your continued willingness to give prompt and thoughtful attention to resolution of this pressing and significant issue.

Sincerely yours,

Edwin M. Jones
Executive Director

Attachment

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" Definition
a Plan

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

JAN 12 1984

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RECEIVED [illegible]

Dear Mr. Rose:

For the past several years, the Treasury Department, the IRS, and the PBGC have been examining a number of issues involving the definition of a single pension plan and the transfer of pension plan assets and liabilities. In some situations, these issues involve attempts to take advantage of the pension plan termination insurance system through plan devices having no economic substance and no other purpose.

We have long agreed that a consistent approach to these issues by the agencies is essential to the smooth administration of ERISA. In order to minimize interagency consultation each time one of these questions arises and to provide additional guidance to the public in these areas, we believe that it is appropriate to issue with your cooperation one or more revenue rulings on this subject.

Therefore, I would like to confirm our position regarding a situation involving a single plan to which more than one employer contributes.1/ The plan provides that, in the event that a contributing employer ceases participation in the plan, the plan trustees have the authority to determine an amount of plan assets attributable to contributions of the withdrawn employer and to limit all pension benefits of the participants attributable to the withdrawn employer to that amount. The plan trustees, treating the invocation of these provisions upon the employer's withdrawal as the simultaneous creation and termination of a separate plan, submitted a notice of intent to terminate to the PBGC.

1/ In our discussion the term "single plan" was used as it is defined in IRS and PBGC regulations -- Treas. Reg. 1.414(1) and 29 C.F.R. 2617.2 -- and interpreted in IRS letter rulings and PBGC opinion letters.

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In our discussion with representatives of the PBGC, we concluded that the implementation of such a plan provision would not give rise to a separate plan. In other words, the restriction of assets under the plan cannot be characterized as a spinoff, as described in Treas. Reg. 1.414(l). We noted that there is no employer maintaining the alleged spun off "plan" where the withdrawn employer has not undertaken the obligation to make continuing pension contributions and where the alleged "plan" terminated upon its creation having received no contributions and under which no new benefits accrued.

We agreed that unless a separate plan were created, the use and existence of such a provision in the principal plan limiting vested benefits to the attributable assets would violate the vesting provision of the Internal Revenue Code.

Thank you for your continued assistance.

Sincerely,

Donald C. Lubick
Assistant Secretary
(Tax Policy)

Henry Rose, Esquire
General Counsel
Pension Benefit Guaranty Corporation
2020 K Street, N.W., Suite 7200
Washington, D.C. 20006

Pension Benefit Guaranty Corporation
Memorandum

TO:

FROM:

UBJECT:

__Facts__:

On December 8, 1981, the McLouth Steel Corporation ("Old McLouth") filed a petition for reorganization under Chapter 11 of the Bankruptcy Code. After many months of improved operations as debtor-in-possession, Old McLouth received a letter of intent to purchase substantially all of its assets from industrialist Cyrus Tang.

The Tang offer was contingent upon satisfactory accord with the United Steelworkers of America (the "Steelworkers"). As we understand the facts, Tang initially did not want to assume any portion of Old McLouth's pension plans. It apparently proposed to establish new plans for the employees of the new corporation it intended to establish to purchase Old McLouth's assets. The Steelworkers, however, insisted on continuation of the McLouth Hourly Employees Pension Plan ("Old Hourly Plan"). Tang, seeing the potential liabilities under the plan, insisted on avoiding controlled group liability for other trades and businesses he owned. After extensive negotiations with the Steelworkers and the PBGC concerning the potential controlled group liability, Tang broke off negotiations and apparently found another investor to take enough stock in the new corporation to avoid controlled group liability. Further, it appears that Tang reached agreement with the Steelworkers whereby the new corporation would only continue a portion of the Old Hourly Plan.

On November 12, 1982, Old McLouth's Board of Directors took the following actions effective as of November 15, 1982, the closing date of sale of Old McLouth's assets to the new corporation, McLouth Steel Products ("New McLouth"):

1) Amended the McLouth Salaried Employees Pension Plan (the "Salaried Plan") to spin-off all active Salaried Plan participants represented by the Steelworkers. (Estimated at a little over 160 participants.)

2) Amended the Old Hourly Plan to accept union workers who were spun-off from the Salaried Plan.

3) Amended the Old Hourly Plan to spin-off all active union employees employed by Old McLouth on the closing date into a plan substantially the same as the Old Hourly Plan (the "New Hourly Plan").

4) Amended the New Hourly Plan to provide for its adoption by New McLouth.

The Old McLouth Board also authorized termination of the Salaried Plan as of November 30, 1982. Termination of the Old Hourly Plan was to take place, after consent of the Steelworkers, also on November 30, 1982.

On November 15, 1982, New McLouth's sole director executed corporate resolutions which adopted the New Hourly Plan contingent expressly on Old McLouth's completion of actions 1 through 4, above. (We understand that the Steelworkers had agreed to termination of the Old McLouth Hourly Plan, effective November 30, 1982.)

On November 19, 1982, the PBGC received documents purporting to be Notices of Intent to Terminate the Salaried Plan and the Old Hourly Plan. On December 15, 1982, the PBGC received two reportable event notices dated December 13, 1982, from Old McLouth reporting the Internal Revenue Service's ("IRS") denial for both Plans of pending funding waivers for plan years 1980 and 1981, and its intent to revoke upon plan termination the funding waivers granted for the 1979 plan year for both Plans.

On December 20, 1982, the PBGC received a reportable event notice dated December 15, 1982, which gave notice of the purchase by New McLouth of substantially all the assets of Old McLouth. The document also provided notice of the prior spin-off of the active employees from the Old Hourly Plan and the subsequent adoption by New McLouth of the New Hourly Plan.

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

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BMN(B)

SEP -3 1982

Alan D. Lebowitz
Assistant Administrator for
Fiduciary Standards
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, D.C. 20210

Dear Alan:

Pursuant to our conversation on this subject, I would like to request a formal opinion as to whether or not the following situation would constitute a prohibited transaction.

IRS has granted minimum funding waivers under Code Section 412 subject to the following condition in certain instances:

> "If a plan terminates while any portion of the funding waiver for that plan remains unamortized, sufficient plan contributions will be made so that at the end of the plan year in which the termination occurs the plan's funding standard account has a credit balance (treating a debit balance as a negative credit balance) of not less than the unamortized amount of the funding waiver"

The condition above amounts to a "due on termination" clause with regard to the unamortized portion of the waived amount. If, in addition to the "due on termination" clause, IRS were to provide that the sponsor provide collateral to the plan to secure the amount conditionally waived, would this constitute a prohibited transaction? If so, would such an arrangement require Department of Labor approval on a case-by-case basis or could a blanket waiver be granted?

I would appreciate an early response because of current pending matters. Thanking you in advance for your cooperation.

Sincerely yours,

Bill DeHarde
William DeHarde
Director, OPO

cc: Ira Cohen

U.S. Department of Labor

Labor-Management Services Administration
Washington, D.C. 20216

Reply to the Attention of

[illegible] 29 [illegible]

Mr. S. Allen Winborne
Assistant Commissioner (EP/EO)
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Western Airlines, Inc., Pilots Fixed Pension Plan

Dear Mr. Winborne:

We have been made aware by the Pension Benefit Guaranty Corporation (PBGC) of a proposed arrangement under which the Western Airlines Inc., Pilots Fixed Pension Plan is to be terminated. It is our understanding that pursuant to the termination, certain "ancillary benefits" are to be eliminated retroactively, resulting in an actuarial surplus on termination of approximately 24 million dollars which is to be paid to the employer.

Our preliminary analysis of the material made available to us by the PBGC suggests that the principal issue presented is whether or not such a retroactive elimination of benefits is permissible under applicable provisions of ERISA and the Internal Revenue Code.

As you know, under section 101 of Reorganization Plan No. 4 of 1978, interpretive authority with regard to provisions of ERISA and the Code relating to benefit accruals was lodged with the Secretary of the Treasury. In consideration of what, if any, further actions the Department should undertake, we would appreciate the views of the Service with respect to the question posed above.

I am enclosing copies of those documents which we received from PBGC that appear to us to be relevant to such an interpretation in the event they were not similarly provided to you. My staff and I are available to discuss this matter with you and your staff as necessary. It appears that events are moving very rapidly and, accordingly, we believe that expeditious consideration of these matters by our agencies is particularly important.

Sincerely,

Jeffrey N. Clayton
Administrator
Pension and Welfare Benefit Programs

Enclosures

PWBP/OFS/ADLebowitz/mer/12-29-82

U.S. Department of Labor

Labor-Management Services Administration
Washington, D.C. 20210

Reply to the Attention of:

DEC 29 1982

Mr. Roscoe L. Egger, Jr.
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Mr. Egger:

Under Income Tax Regulations section 301.6103(l)(2)-3(b), we request returns and return information regarding the Western Airlines, Inc., Pilots Fixed Pension Plan. This information is to include all documents and data relating to possible violations of applicable provisions of the Internal Revenue Code relating to plan qualification and possible violations of sections 404 and 406 of the Employee Retirement Income Security Act of 1974. We believe this disclosure is necessary to assist us in our enforcement of Title I of ERISA.

In addition to myself, the requested information will initially be made available to John J. Walsh, Deputy Assistant Secretary, Labor-Management Services Administration; Alan D. Lebowitz, Assistant Administrator for Fiduciary Standards, Pension and Welfare Benefit Programs; and to Robert N. Eccles, Acting Deputy Associate Solicitor, Pension Benefit Security Division, Office of the Solicitor. As necessary, other individuals in the Labor-Management Services Administration and Office of the Solicitor may have access to this information.

Sincerely,

Jeffrey N. Clayton
Administrator
Pension and Welfare Benefit Programs

PWBP/OFS/ADLebowitz/mer/12-29-82
cc: Clayton/Klevan/Lebowitz/Chron

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PBGC
Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

DEC 27 1982

Mr. Jeffrey Clayton
Administrator, Pension and
Welfare Benefit Program
United States Department of Labor
200 Constitution Avenue, N. W.
Washington, D. C. 20210

Dear Jeff:

In accordance with your suggestion, I am enclosing a copy of the material in our files regarding termination of Western Airlines Pilots' Fixed Pension Plan.

I understand that you will be calling me within the next two or three days with respect to your thoughts on the enclosed documents and the facts elicited in the December 27 meeting with Western Airlines.

Sincerely yours,

Ed Jones

Edwin M. Jones
Executive Director

Enclosures

Alan Lebowitz ✓30

Internal Revenue Service
Department of the Treasury

Assistant Commissioner
(Employee Plans and
Exempt Organizations)

Washington, DC 20224

JAN 25 1983

Mr. Jeffrey N. Clayton
Administrator
Pension and Welfare Benefit Programs
Department of Labor
Washington, DC 20216

Re: Western Airlines, Inc.
Pilots Fixed Pension Plan

Dear Mr. Clayton:

You asked our opinion as to whether there has been a reduction in accrued benefits in the arrangement under which the above-named plan (the Plan) is to be terminated.

The "Second Amendment" to the Plan eliminated certain ancillary benefits from the Plan and changed the amount of several benefits available from the Plan. The only issue concerning the elimination of these benefits centered on a benefit which was a social security supplement within the meaning of section 411(a)(9) of the Code.

Because of the nature of such elimination, we have concluded that the elimination was permissible.

Sincerely,

(Signed) S. A. Winborne

S. Allen Winborne
Assistant Commissioner
(Employee Plans and
Exempt Organizations)

cc: Ed Jones PBGC

U.S. Department of Labor

Office of the Solicitor
Washington, D.C. 20210

FEB 10 1984

MEMORANDUM FOR THE SECRETARY

THROUGH: MARK D. COWAN
Chief of Staff

FROM: FRANCIS X. LILLY
Deputy Solicitor, Chairman
DOL Working Group on Plan Terminations

SUBJECT: Terminations of Defined Benefit Pension Plans

BACKGROUND

In 1983, there was a marked increase in the number of terminations of defined benefit pension plans resulting in the reversion to plan sponsors of those assets in excess of the amounts needed to fund all plan obligations when due. The Pension Benefit Guaranty Corporation (PBGC) has indicated that, since January 1980, it has issued notices of sufficiency to 166 companies which have terminated their plans and received reversions of $1 million or more. Such reversions total approximately $1.15 billion, or about 42% of all assets of such plans upon termination. Of these amounts, $566 million, about 50% of the total, reverted to employers in the last quarter of 1983 as a result of 36 plan terminations. Currently, the PBGC has under consideration 27 other proposed terminations involving possible additional reversions of $576 million. Hundreds of thousands of plan participants have been or will be affected by these terminations.

Because of the number of plans and plan participants and beneficiaries affected, and the amounts of money involved, Congress and the media have begun examining this trend toward plan termination. The business media, especially the pension-oriented press, have focused on what some have tried to portray as abuse by plan sponsors in these situations. Congressional attention has mainly been evidenced in hearings in 1982 and 1983 before the House Select Committee on Aging, chaired by Rep. Edward R. Roybal, at which a number of witnesses including PWBP representatives testified. Despite the information elicited at these hearings, the Select Committee continues to have questions with regard to the Department's role in this area. As a result, the Department has received two requests for information from Rep. Roybal by letter dated November 3, 1983 to you, and by letter dated November 4, 1983 to Alan D. Lebowitz. The primary thrust of these requests deals with the possible applicability of the fiduciary provisions of the Employee Retirement Income Security Act of 1974 (ERISA) to plan terminations and the Department's responsibilities with regard to terminations resulting in reversions of plan assets to plan sponsors. Further, we understand that there is a possibility that legislation will be introduced limiting reversions or suspending for a time terminations resulting in reversions.

Concurrently, the executive agencies involved in the pension area have been actively considering the legal, economic and policy issues raised by defined benefit plan terminations. These issues were first raised by the PBGC as the agency most directly involved with plan terminations. The PBGC has been pressing for several months for the development of an Administration position on terminations resulting in reversions, and currently faces a number of termination situations requiring prompt agency action. In response to the PGBC's concerns, the IRS in 1983 initiated an on-going review of terminations involving reversions of more than $1 million. Now, the IRS, along with the Treasury Department, has under serious consideration a far-reaching position with regard to plan terminations resulting in reversions. A coherent Administration position needs to be reached as to the legal and policy issues raised by such terminations. The purpose of this memorandum is to provide the basis for the Department of Labor's participation in this inter-agency discussion, and to consider the various options for action in this area.

A. Voluntary Plan Termination System.

Current law provides for a process of voluntary plan termination subject to the supervision of the PBGC under title IV of ERISA. Under section 4041 of ERISA, the administrator of a single-employer defined benefit plan may voluntarily terminate a plan subject only to the issuance of a PBGC "sufficiency letter" indicating the PBGC's finding that the plan's assets are sufficient to discharge when due all plan obligations up to the level guaranteed by the PBGC. The PBGC must issue a sufficiency letter, or notify the plan that it is unable to make a finding of sufficiency, within 90 days of the filing of the termination notice, unless the parties agree to an extension. (Voluntary termination of multiemployer plans is governed by ERISA section 4041A pursuant to complex rules not pertinent to the current discussion.) Section 4042 allows the PBGC to initiate involuntary plan termination proceedings in specified instances of plan financial distress. Upon termination, ERISA section 4044 provides that plan assets must first be allocated to pay all benefits. Subsection 4044(d) allows for the reversion of residual assets to the plan sponsor if certain conditions are met, including that the reversion does not contravene any provision of law.

Although the IRS and the Department of Labor are responsible for the regulation of on-going plans, they have had only limited involvement in plan terminations. IRS involvement occurs in two types of situations. First, the plan administrator usually requests an IRS "determination letter" (i.e., an IRS written opinion) that, upon termination, the plan qualifies for favorable tax treatment under section 401 of the Internal Revenue Code, and, on its face, meets the requirements of ERISA. Second, IRS may choose to examine the tax status of a terminated plan upon referral from the PBGC or the Department, or as a result of a field audit. In line with these two responsibilities, the IRS National Office, on August 25, 1983, instructed the field offices to refer to the National Office certain types of terminations causing a reversion of more than $1 million to the plan sponsor. 1/ It should be noted, however, that in IRS regulations relating to the vesting of plan benefits upon termination, the IRS states that it will consider a plan to be terminated if the plan termination occurs in accordance with the provisions of sections 4041 and 4042 of ERISA (26 CFR §1.411(d)(2)). Because sections 4041 and 4042 are administered by the PBGC, this regulation may be read as reinforcing the notion that the PBGC has primary authority to determine when plan terminations occur.

The Department has taken no formal part in the termination process to date. The Department's consistent position, as expressed in two separate appearances before the House Select Committee on Aging, has been that the decision to terminate a pension plan under the present system of voluntary terminations is not subject to ERISA's fiduciary rules. The Department has viewed termination as a business decision rather than

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1/ So far, this process has produced two referrals to the IRS National Office. The first involved the termination by one employer of four plans and the possible reversion of $400 million. We understand that the National Office has decided to take no action with regard to these terminations and has sent these matters back to the District Offices for the issuance of favorable determination letters. The second, involving the reversion of $100 million to AMAX, Inc., is currently being studied by the IRS in light of the PBGC's tentative acceptance of the employer's proposed settlement. The AMAX situation is discussed below.

a fiduciary decision. This would be true even where the employer or its representative is a plan fiduciary, because when such an employer decides to terminate, the Department would find no exercise of fiduciary authority. The Department has stated, however, that the implementation of the decision to terminate could raise fiduciary violations. The positions articulated by the Department were recently endorsed by a federal judge ruling in private lawsuits relating to the Harper & Row termination.

Just as the PBGC, IRS, and DOL have different statutory bases for action in the termination area, so too do these agencies bring differing concerns to bear in attempting to deal with defined benefit plan terminations. The PBGC, as an insurer of plan benefits, must be concerned that any inter-agency position will not unduly increase PBGC exposure for unfunded plan liabilities either by unnecessarily encouraging terminations, or by discouraging the formation and continuance of defined benefit plans, thereby eroding PBGC's premium base. The IRS is primarily concerned that terminations do not result in tax abuse, 2/ and that there is adequate enforcement of ERISA's minimum funding standards. The Department's focus is on assuring the consistent and logical enforcement of the fiduciary standards committed to its administration, and in assuring the overall development of a national pension policy. These three sets of concerns, while not necessarily contradictory, are also not coextensive. Thus, a policy position in this area which avoids tax abuse and abides by ERISA's fiduciary standards may still drastically increase PBGC's risk exposure. Conversely, a position designed to minimize the PBGC's risks may encourage tax abuse or raise serious questions for the Department. Any coordinated policy adopted by these agencies will have to balance these considerations along with the other legal and policy issues raised by the various types of defined benefit plan terminations. Moreover, in light of the enormous amounts of money involved and the ever-increasing size of pension plan assets, the Administration must consider the long-term and short-term economic effects of any government-wide policy that is contemplated or established.

2/ It has been suggested that such tax abuse arises because reversions upon termination may, to a certain extent, be inconsistent with the preferential tax treatment accorded pension plans as a means of effecting the national policy favoring a private pension system. Plan contributions are deductible; plan assets accumulate tax-free. ERISA and the Code prohibit employers from removing such assets from an on-going plan. It can be argued that allowing unrestricted access to repeated reversions, especially when the employer can time such reversions to occur in a tax-loss year, permits employers to maintain a tax-exempt fund for purposes other than the payment of employee pension benefits.

B. Types of Terminations.

Although there is only one set of statutory rules governing plan terminations, and despite the fact that terminations differ based on their individual facts, it will be useful for the purposes of this discussion to fit defined benefit plan terminations into four categories. First, there are "straight terminations," which occur when no successor plan is established. These generally involve situations in which the employer is winding up or otherwise limiting its business activities. Second, there is the termination of a defined benefit plan and the establishment of a defined contribution plan (such as a profit-sharing plan) in its place ("DB-DC" termination). The primary difference between these two types of plans is that in the former, the participant's benefit level is fixed based on his or her length of service and salary, whereas in the latter, the contribution level from the employer is fixed and the participant's benefit varies based on the amount in his individual account and any investment earnings on that amount. In addition, the PBGC does not guarantee benefits provided by defined contribution plans, thereby further transferring the risk of loss onto the participant. Third, there is the termination of a defined benefit plan and establishment of another defined benefit plan in its place ("DB-DB" termination or termination/reestablishment). Finally, there is the termination of a defined benefit plan after a portion of the plan (usually covering active participants) has been spun off and continued on an on-going basis ("spin-off" termination). Each of these types of terminations presents additional issues which must be considered.

C. Reversions.

1. Economic Basis. When examining the various types of plan terminations resulting in reversions, it is possible to get the impression that reversions occur only in those limited situations where an employer has overfunded a plan by making larger than necessary funding contributions, and that such overfunding results in the "excess" assets which revert to the employer. However, most of the present reversions are occurring in situations where employers have not made such excessive contributions. In many cases, a plan merely meeting ERISA's minimum funding standards when examined from a long-term perspective (i.e., a plan not overfunded on an on-going basis) will yield a significant reversion to an employer upon termination (i.e., a plan overfunded on a termination basis), due to the interplay of a number of long-term and short-term factors.

In the short run, current economic conditions have contributed to the development of surplus assets eventually realized as reversions. During recent periods of high interest rates, plans have been able to purchase annuity benefits from insurance companies at unusually low single premium rates. For example, the employer might have contributed funds to the plan on the assumption that the investment of plan assets would earn 7% to 8% over the long term. During recent years, and currently, annuities for all plan participants can be purchased from an insurance company on a 12% to 13% basis. This differential results in assets in excess of those needed to pay off all annuity benefits under the plan. If instead of purchasing annuities, the plan provides for the immediate payment of the "lump-sum equivalent" of the annuity's present value, the amount of the lump sum payment will similarly be reduced. Other factors, such as high stock prices, also contribute to such termination over-funding. In view of the large sums involved, employers are understandably anxious to take advantage of these short-term economic conditions, recapture surplus assets, and utilize such reversions for general corporate purposes.

In the long run, certain structural factors involved in plan administration contribute to termination overfunding. For example, ERISA's funding standards, administered by the IRS, permit a number of different funding methods. An employer may fund each year's accrued liability as it is earned. However, as an employer's work force increases in size, age, and longevity of service, the annual funding payments will increase sharply as more liabilities are accrued. In order to avoid potentially devastating funding payments in the future, many employers adopt a level funding method. Thus, funding in the early years of a plan exceeds the amount needed to pay currently accrued benefits. This creates a cushion which is diminished in later years as liabilities increase since this funding method is premised on the notion that pension costs will be a long-term employer commitment. When a plan is terminated in the near term, this cushion designed to defray long-term costs becomes a surplus which employers seek in the form of a reversion. In part, therefore, the plan assets available for reversion result from the nature of conservative plan administration.

Reversionary amounts may also result in part due to the type of benefit formulas employed by plans. Many defined benefit plans express benefits as a percentage of a participant's final pay, or average pay over the final years of employment. Such formulas work to the advantage of plan participants because salaries tend to increase in direct correlation to length of service. Employers must fund such plans in anticipation of future salary increases. If an employer terminates its plan in the near term, however, these future salary increases become irrelevant, and funding payments made in anticipation of such increases cause the plan to be overfunded on a termination basis, thereby resulting in excess assets which may revert to the employer.

In each of these situations, an employer, rather than terminating a plan, may adjust its future funding payments to avoid overfunding the plan on an on-going basis. Such adjustments would result in the diminution of excess assets and their indirect accrual to the employer's benefit over time through reduced funding payments. Many employers, however, cannot or will not wait for such long term returns. Others believe that a plan overfunded on a termination basis attracts take-over bids by other entities interested in procuring the surplus plan assets. These considerations have led, in part, to an increase in the number of terminations.

2. Legal Basis. Current law clearly recognizes circumstances under which plan assets may revert to plan sponsors upon plan terminations. Under the Internal Revenue Code, section 401(a)(2) states that a plan will fail to be tax qualified unless, under the trust instrument, it is impossible, before the satisfaction of all liabilities to participants and beneficiaries, for any part of the trust corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries. With respect to the satisfaction of liabilities, IRS regulation 26 CFR §1.401-2(b)(1) recognizes that residual assets resulting from "actuarial error" can revert to the employer upon termination:

> The intent and purpose in section 401(a)(2) of the phrase "prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust" is to permit the employer to reserve the right to recover at the termination of the trust, and only at such termination, any balance remaining in the trust which is due to erroneous actuarial computations during the previous life of the trust. A balance due to an "erroneous actuarial computation" is the surplus arising because actual requirements differ from the expected requirements even though the latter were based upon previous actuarial valuations of liabilities or determinations of costs of providing pension benefits under the plan and were made by a person competent to make such determinations in accordance with reasonable assumptions as to mortality, interest, etc., and correct procedures relating to the method of funding.

The regulation goes on to state that such "actuarial errors" result when the plan's experience differs from the reasonable interest rate, mortality, etc. assumptions made in order to administer the plan on a sound basis. Acceptable reversions are then distinguished from impermissible reversions composed of excess assets resulting from changes in the plan's benefit provisions or eligibility rules. Thus, the mere fact of a reversion will not alone cause a plan to be disqualified upon termination.

Similarly, title IV of ERISA provides for the reversion of assets to the plan sponsor upon plan termination. Section 4044(d)(1) of ERISA states:

> Any residual assets of a single employer plan may be distributed to the employer if -
>
> (A) all liabilities of the plan to participants and their beneficiaries have been satisfied,
>
> (B) the distribution does not contravene any provision of law, and
>
> (C) the plan provides for such a distribution in these circumstances.

Several courts have indicated that the employer has a legal right to the reversion of residual assets (other than those attributable to employee contributions) if the criteria of section 4044(d)(1) are met. *E.g., Washington-Baltimore Newspaper Guild v. Washington Star Co.*, 555 F. Supp. 257, 262 (D.D.C. 1983); *In re C.D. Moyer Co. Trust Fund*, 441 F. Supp. 1128, 1132-33 (E.D.Pa. 1977), *aff'd* 582 F.2d 1273 (3d Cir. 1978).

Title I of ERISA reflects the policy expressed in section 4044(d)(1). Section 403(c)(1) of ERISA states:

> Except as provided in paragraph (2), (3) or (4) or subsection (d), or under section 4042 and 4044 (relating to termination of insured plans), the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan.

The Department has never attempted to rely on section 403(c)(1) to challenge a termination or reversion.

ROLE OF THE DEPARTMENT OF LABOR 3/

To the extent the Department is to take an active role with regard to plan terminations which result in reversions, three determinations are necessary. First, the Department must ascertain the limits of its jurisdiction in this area as a legal matter. Second, the Department must determine what policy considerations must be brought to bear on the issues presented by reversions. Third, the Department must consider the options for action presented by the other agencies involved in this area and determine not only the viability of each option but also the ramifications of each option for pension plans in general and on the formulation of national plan policy.

A. Legal Considerations.

1. Section 403(c)(1). As noted earlier, the Department has indicated in Congressional testimony and in its consideration of the Harper & Row termination 4/ that the decision to terminate is not subject to ERISA's fiduciary standards. It has been suggested, however, that the interplay of sections 403(c)(1) and 4044(d) of ERISA give the Department the authority to determine separately from the PBGC and IRS whether a termination has occurred for title I purposes.

Section 403(c)(1) provides that the "no inurement" rule shall apply "except as provided ... under section 4042 and 4044 ...." There is no direct legislative history construing this phrase, although we are continuing our legal research. However, several

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3/ This discussion focuses only on the Department's institutional role in this area. This should be distinguished from the Secretary's personal role as Chairman of the Board of Directors of the PBGC.

4/ In this situation, Harper & Row decided to terminate its defined benefit pension plan, recover the residual assets after satisfying plan liabilities, and use those funds to purchase outstanding stock in order to avoid a possible take-over attempt. Harper & Row then formed an employee stock ownership plan (ESOP) to hold employer stock. The Department decided not to join in litigation filed by an individual participant and by a labor union representing Harper & Row employees in part because of the Department's determination that termination is a business decision. On January 8, 1984, the United States District Court for the Southern District of New York granted summary judgment for Harper & Row on plaintiffs' ERISA claims, citing the Department's position in Congressional testimony.

factors do appear to indicate that the Department does not have the authority to determine whether a termination has occurred for title I purposes. First, section 4044, relating to the distribution of assets upon plan termination, is part of title IV of ERISA and is therefore committed to the authority of the PBGC. Second, section 403 of ERISA specifically recognizes the Department's regulatory role with regard to the distribution of assets upon termination of a welfare plan (§403(d)(2)) and a pension plan not covered by the Title IV of ERISA (§403(d)(1)), and allows the Secretary to make exceptions to the "no inurement" rule by regulation in those situations. Section 403(c)(1) contains no such explicit grant of authority for the Department with regard to section 4044. Third, section 408(b)(9) specifically exempts from the prohibited transaction provisions of section 406 the distribution of assets upon plan termination if such distribution is made in accordance with the plan documents and section 4044. Section 406 is one of the Department's primary tools for enforcing ERISA's fiduciary standards. The explicit reference in section 408(b)(9) to section 4044 suggests the limitations of the Department's authority with regard to terminations covered by section 4044. Fourth, the IRS possesses authority through the determination letter process under section 401 of the Code to conclude that, upon termination, a plan on its face meets the requirements of ERISA. If the IRS and the PBGC agree to a plan termination (as they did in the Harper & Row situation), it would be difficult for the Department, both as a legal and a practical matter, to overturn those determinations when the Department's primary authority relates to the administration of on-going plans.

On the other hand, there is nothing that specifically prohibits the Department's participation in this area. An argument could be made that the Department's overriding authority necessitates an active role for the Department in determining the existence of a termination for title I purposes. It would, however, be a far easier and ultimately more cogent argument on a solely legal basis to state that the Department is bound for title I purposes to accept the determination of the PBGC and IRS as to the existence of a plan termination. Further, insertion of the Department into the decision of whether a termination has occurred would result in a number of practical problems. The necessity for inter-agency coordination would undoubtedly slow down the termination process. Because the Department could only act in the context of title I, it would ill serve the pension community if certain activities would be viewed as terminations for title IV purposes but not for title I purposes.

2. Section 4044(d)(1)(B). Even if the Department cannot independently state whether or not a termination has occurred for title I purposes, it has been suggested that the Department may still be able to prevent reversions of residual assets through the requirement in section 4044(d)(1)(B) that the reversion not contravene any provision of law. In other words, the Department's authority to enforce the "no inurement" rule depends on whether a reversion meets the conditions of section 4044, which requires in turn that a reversion not contravene any provision of law. Because section 403 does not apply if the requirements of section 4044 are met, and because section 408(b)(9) removes the prohibitions of section 406 from consideration, the only remaining relevant provisions of law within the Department's authority are the fiduciary duty provisions of section 404. However, as noted above, the Department has consistently stated that termination is not a fiduciary decision, and thus section 404 would be inapplicable to that decision. To state otherwise would be to require an analysis of the employer's state of mind or intent in deciding to terminate, and would also run contrary to the voluntary termination system ERISA currently provides. Of course, it is possible that a reversion may violate some other provision of law outside of the Department's ERISA enforcement authority.

Further, if a distribution occurs according to the provisions of section 4044 and residual assets remain, it would be difficult to argue that section 404 prohibits an employer from recognizing such a reversion since section 4044(d) explicitly allows for such a recoupment. This is not to say that the fiduciary standards of section 404 would not apply to transactions in furtherance of plan termination, e.g., allocating assets, choosing a private insurer, etc. The Department has consistently asserted its authority to examine such transactions in light of title I of ERISA.

B. Policy Considerations.

Whichever of the legally defensible positions the Department decides to take in defining its authority in this area, there are a number of policy considerations the Department must take into account. The policy choices may determine, in part, how the Department defines its authority to deal with terminations, and may also serve as a basis for proposing or reacting to future legislative initiatives in this area. These policy considerations fall into four categories relating to how governmental action would affect: (1) employers; (2) plan participants and beneficiaries; (3) the overall mix of different types of pension plans currently available; and 4) other governmental entities.

1. Effect on Employers. As noted above, current law recognizes the validity of a reversion of residual assets upon termination under certain circumstances. Despite the fact that employers are also able to recoup these residual assets indirectly over the long term by reducing funding contributions (although not below ERISA's minimum funding levels), employers may have the expectation that reversion upon termination will provide a faster, legally acceptable method of garnering these sums should the need arise. This expectation, especially to the extent it causes employers to establish defined benefit plans and fund them adequately, must be considered in the development of a national policy dealing with terminations.

2. Effect on Plan Participants. Plan participants are the persons most immediately affected when a pension plan is terminated. Even though the participants may be fully vested in their accrued benefits upon termination, it has been argued that the participants bargained for a long-term pension commitment with benefits based upon longevity of service or final pay some time in the future. The annuities or lump sums participants receive in the event of a near term plan termination do not reflect these expectations. The unilateral manner in which these expectations are frustrated, and the possibility of such losses of long-term security from the private pension system are in large part the reason for Congressional concern.

3. Effect on Choice of Plans. It has been suggested that, if there is a limitation on an employer's ability to terminate a plan and receive a reversion of residual assets, such a limitation would deter employers from establishing or continuing defined benefit plans. Recent reports indicate that more employers are opting to establish defined contribution plans in order to achieve an ease of administration and lower contribution levels. See, e.g., BNA PENSION REPORTER, Nov. 21, 1983, p. 1747. Restrictions on reversions may further this trend. Although defined contribution plans may provide an adequate retirement income (as in the case of a young employee who stays with one employer for most of his career), the risk of loss in these plans is on the individual participant. The participant is never sure what his or her retirement income will be, whereas participants have the certainty of benefit levels in a defined benefit plan. The range of types of plans offered by employers would be further skewed if any policy position discouraged reversions only in DB-DB or spin-off situations, as the IRS has suggested. This suggestion is discussed below.

4. Other Government Agencies. The PBGC will be most directly affected by any inter-agency policy adopted in this area. As an insurer, PBGC's exposure to loss will vary directly with the ease with which such terminations are allowed to occur. For example, in the spin-off situation, although the terminated "non-active" plan may be sufficient for present PBGC purposes, the on-going "active" plan may not be as well-funded as the entire plan before the spin-off, and may pose a risk to the PBGC in the future. On the other hand, if reversions are restricted and employers decide to establish defined contribution plans, the PBGC's premium base will be eroded since the PBGC does not guarantee benefits provided by defined contribution plans and therefore does not receive premium payments from such plans. This erosion would add to the PBGC's current financial difficulties. In addition, as the number of terminations resulting in reversions increases, the PBGC faces heightened pressure to determine the sufficiency of these terminated plans within the 90-day statutory limit. Therefore, the PBGC would benefit from an early resolution of these problems.

Policy decisions regarding terminations must also take into account the role of the Treasury Department and IRS as guardians against tax abuse. Treasury and IRS set national tax policy, and often there is no bright line separating tax policy from pension policy. The Department of Labor, as primary pension policymaker, cannot ignore tax concerns raised by Treasury and IRS.

One other government agency to be considered in this area is the Social Security Administration. To the extent that the policies adopted by the government discourage the development of a reliable private pension system, more and more retirees will look to the already overburdened Social Security system for retirement income.

C. Options

The legal and policy considerations outlined above must be applied to the assessment of the various government-wide options currently being presented in this area. These options are discussed briefly below.

1. Maintain the Status Quo. Consistent with its previous statements, especially with regard to the Harper & Row termination, the Department may wish to take no action concerning plan terminations resulting in reversions. This would avoid the necessity of examining employer motivation, and would not deter formation or maintenance

of defined benefit plans. This position, however, poses the fewest conceptual problems only when it is restricted to the straight termination situation. In the more complex DB-DC, DB-DB, or spin-off situations, employer intent may be an important element of concern, and the resulting reversions, while legal, may raise policy issues. Further, this position does not provide extra protections for participants, and may ignore the long-term problems for the stability of the private pension system posed by such reversions. This position also does not aid the PBGC in its current financial difficulties.

2. PBGC Negotiated Settlements. This position would not entail the Department's changing its current legal position with regard to voluntary terminations. The Department would merely support the PBGC's efforts to secure additional protections before accepting a termination involving a reversion, along the lines of the PBGC's proposed settlement with AMAX, Inc. The AMAX situation involves a spin-off termination and a possible reversion of $160 million. AMAX has offered, among other things, to give up $60 million to assure the present financial status and the future viability of the "active" plan. Such an arrangement would reduce the risk of PBGC exposure to loss, and may indirectly benefit participants by further assuring the integrity of their benefits due to this funding cushion. Obviously, this approach is applicable only in DB-DB and spin-off situations, since only then would the PBGC have authority with regard to the resulting plan. The PBGC would not be likely to seek surplus sharing solely for the benefit of plan participants in a straight termination or DB-DC situation where the terminated defined benefit plan is sufficient. However, even where the PBGC is likely to take action, the PBGC itself has recognized that the legal basis for such negotiated settlements is questionable. (See attached PBGC policy briefing paper.) The presence or absence of employer guarantees does not change the legal status of a DB-DB or spin-off as a termination under title IV of ERISA. In addition, if the PBGC scrutinizes only DB-DB or spin-off terminations, employers may opt for straight or DB-DC terminations, to the ultimate detriment of plan participants. Furthermore, even with employer guarantees, the resulting plans may not be as well-funded on an on-going basis as the entire plan was before termination.

3. Regulatory Standards. The Treasury Department is currently considering proposing regulations which would impose certain requirements on employers terminating plans and receiving reversions. These requirements would be similar to those offered to the PBGC by AMAX, Inc., and would undoubtedly mandate some sort of funding cushion for the on-going plan. However, Treasury intends that such requirements would apply only in spin-off and DB-DB situations. Although Treasury

is only in the preliminary stages of considering this possibility, it is clear that this option shares many of the positive and negative aspects of PBGC negotiated settements discussed above. Most notably, the legal basis for such requirements is, at best, unclear, and any such Treasury regulation could significantly discourage the formation of defined benefit plans.

4. Excise Tax. It is our understanding that the Treasury Department is considering a legislative proposal involving an excise tax on any amounts reverting to employers in order to discourage employers from seeking such reversions and to prèvent corporate income tax manipulation. This proposal would not directly help plan participants, and might also discourage the maintenance of defined benefit plans. Further consideration of this option must await action by the Treasury, perhaps in the form of a legislative proposal.

5. "Substance-Over-Form" Approach. The Treasury has proposed that, as a matter of policy, the IRS should not give a favorable determination letter in certain situations where an employer has terminated a plan solely to receive a reversion of residual assets. In other words, the IRS does not want to allow employers to do indirectly what sections 401(a)(2) of the Code and 403 of ERISA would prohibit them from doing directly (i.e., take assets from an on-going plan). The IRS has indicated that it will ignore the "form" of a transaction to reach its "substance" only in spin-off or DB-DB terminations because these situations present the greatest possibility for arguing that no termination has, in fact, taken place. Another reason for this proposal is the feeling that many other factors could cause an employer to effect a DB-DC or straight termination, and that, as a result, the substance over form approach would be ineffective in those types of cases.

However, this approach poses several serious questions. First, the IRS has not clearly articulated any legal basis for adopting this position. Although this proposal appears to be premised on some notion of preventing tax abuse, the lack of articulation makes it difficult to assess the viability of this option. Second, although possibly motivated by the desire to protect plan participants, this approach may be the most detrimental of all the options currently being studied to participant interests. Not all spin-off or DB-DB terminations are injurious to plan participants since, in both cases, participants continue to be covered by a defined benefit plan, with its attendant security of benefit levels. Indeed, the proposed AMAX settlement could work to the benefit of all participants, active and non-active, due to the presence of employer guarantees. However, by focusing solely on spin-off or DB-DB terminations, this approach could cause more employers to use DB-DC or straight terminations to avoid restrictions on reversions. Certainly, encouraging employers to terminate defined benefit plans without establishing a successor plan would not be in the interest of plan participants. Further, it could not be viewed as benefiting plan participants when the successor plan shifts the risk of loss from the employer onto the participants themselves. Third, there does not appear to be a legal basis for ignoring employer intent in some cases but not in others. This is especially true when the government would be restricting the less extreme cases. Finally, this suggestion could seriously skew the types of pension plans maintained by employers in favor of defined contribution plans for reasons having nothing to do with the normal economic and labor concerns considered by employers.

6. Interim Position. Because of the increasing pressure on the government (especially the PBGC) to adopt a policy to deal with terminations resulting in reversions, representatives of the PBGC, Treasury, IRS and DOL have begun discussing the possibility of adopting an interim position to deal with these terminations while a long range policy is being developed. The PBGC has suggested that such an interim policy should require (or allow the PBGC to secure) a funding cushion (as discussed in Options 2 and 3, above) as a prerequisite to accepting a spin-off termination. PBGC would continue to process DB-DB, DB-DC, and straight terminations on a normal basis (as discussed in Option 1, above). Although spin-off and DB-DB terminations share some conceptual similarities, the PBGC would justify this difference in treatment by taking the position that the spin-off situation is actually a partial termination not insured under title IV of ERISA. In the spin-off situation, only the non-active participants feel the direct effects of a plan termination; the active participants continue to be covered by the on-going portion of the original plan. In a DB-DB termination, it would be argued that all employees are affected by the termination of the entire original plan, even though a new, albeit similar defined benefit plan is subsequently established. The Department has indicated a willingness to accept the PBGC suggestion as a short-term solution because of the practical necessity for prompt action.

Treasury and IRS, however, object to the PBGC proposal for interim action. Treasury and IRS state that the "substance-over-form" doctrine (discussed in Option 5, above) applies equally to spin-off and DB-DB terminations since in both situations the net effect is to allow the plan sponsor to receive a reversion without significantly altering the nature of pension benefits provided to plan participants. DB-DB terminations may pose a greater threat to the interests of plan participants and beneficiaries than spin-offs due in part to the five year phase-in of guaranteed benefits for new plans under title IV.

Therefore, although the agencies involved agree on the necessity for an interim policy, there is no consensus as to the substance of such a position. To the extent that any interim policy reflects the long-term options discussed above, the short-term position will share the strong and weak points of such options. In addition, we understand that a large number of employers are delaying plan terminations pending the enunciation of a government-wide position with regard to reversions. Adoption of an interim solution may provide a "window" period which would unnecessarily encourage a rash of such terminations.

7. Legislation. The Department may wish to consider whether to suggest or support amending ERISA to deal with this problem. One such possible legislative proposal involves a short-term moratorium on all plan terminations resulting in reversions. Others may involve more direct amendments to ERISA's fiduciary or termination provisions. The Department's position on any legislative initiative would, of course, depend upon the various policy factors discussed above.

CONCLUSION

Given the current statutory framework and in light of present economic conditions, it is unlikely that the issue of reversions upon plan termination will disappear without some further governmental action. The complexity of these issues militates against easy or quick resolution, particularly because the types of termination chosen to effect reversions have far-reaching ramifications for the current private pension system. Nevertheless, the PBGC, which is under time constraints to respond to requests for letters of sufficiency, is pressing for some decision by the Department in the near future. It would be most beneficial if such a decision could be made by all the agencies involved so as to assure a coherent approach to this area in light of the legal and policy considerations discussed above. Bill Niskanen has indicated that he is hopeful that this issue can be presented to the Cabinet Council on Economic Affairs by late February. Before we are in a position to decide finally among the available options, it seems crucial that we perform our own economic study of the ramifications of the possible options so that we act on the basis of hard facts rather than mere speculation. In accordance with our earlier discussion, while we are considering these complex issues, we intend to conduct our own economic assessment to be completed on an expedited basis so as to faciliate Departmental decisionmaking before the planned discussion of termination issues at the Cabinet Council level.

[illegible]

United States Senate
COMMITTEE ON LABOR AND
HUMAN RESOURCES
WASHINGTON, D.C. [illegible]

February 29, 1984

Mr. Frank Lilly
Deputy Solicitor
U.S. Department of Labor
200 Constitution Avenue, S.W.
Washington, D.C. 20210

Dear Mr. Lilly:

In light of your pending nomination before the Senate Labor and Human Resources Committee, I would be interested in knowing your involvement in the decision by the Department of Labor not to make available documents to the House Subcommittee on Labor Standards. As you are probably aware, such documents concern the Subcommittee's investigation into ex parte meetings between the Director of Health Standards for the Occupational Safety and Health Administration and a representative of Union Carbide and the effect of those meetings on the agency's subsequent rulemaking on the use of a particular hazardous chemical.

Please provide your description of the materials involved, including any information the documents provide with respect to the issue before the Subcommittee and a copy of the legislative analysis and basis for withholding this material.

I look forward to receiving your response as soon as possible.

Sincerely yours,

Howard M. Metzenbaum
United States Senator

HMM:fda

BEST AVAILABLE COPY

U.S. Department of Labor

Office of the Solicitor
Washington, D.C. 20210

MAR 7 1984

Honorable Howard M. Metzenbaum
United States Senate
Washington, D.C. 20510

Dear Senator Metzenbaum:

This is in response to your letter of February 29, 1984, concerning a decision by the Department of Labor that because certain documents were personal, not official, it was not possible for the Department to produce them in response to a request from a Congressional subcommittee.

The role of the Office of the Solicitor in this determination was as follows: Consistent with the Department's practice with regard to congressional requests for information, Solicitor's Office staff was asked by the Occupational Safety and Health Administration (OSHA) to provide its views on possible legal issues raised by the request and on drafting an appropriate response to the subcommittee. I was advised by my staff that based upon information concerning the nature of the documents being sought and the circumstances surrounding the manner in which the documents were kept, it appeared under applicable legal precedent that they did not constitute "agency records" within the official control of the Department. Rather, I was advised that the document, in all likelihood, constituted the personal property of Dr. Leonard Vance, the OSHA employee who created them. Upon review of the extant document obtained from Dr. Vance, I concurred with the opinion of my staff and so advised the Assistant Secretary for OSHA, to whom the subcommittee's request had been directed. Thereupon, the Assistant Secretary informed the subcommittee of his determination that, since this document was not an official OSHA record, that he would be unable to produce the requested material.

It is important to understand that this determination was not that the documents should be withheld from the subcommittee by OSHA, but only that their status as personal documents did not permit the Department to produce them. I understand that as a result of discussions among the Department, the subcommittee and Dr. Vance, the extant document has been transmitted to the subcommittee. I believe that this resolution has accommodated the interests of all concerned parties.

In brief, the documents requested were diaries or journals of Dr. Vance's work-related and non-work-related activities, kept solely by him for his personal reference. No agency employee except Dr. Vance exercised any control over them or even had access to them. The journals were never made a part of any agency system of records; Dr. Vance consistently treated them as his personal property. The legal opinion transmitted to the Assistant Secretary for OSHA advises that, under these circumstances, the journals do not constitute agency records over which OSHA had control. *See*, *British Airports Authority v. CAB*, 531 F.Supp. 408 (D.D.C. 1982); *Porter County Chapter of the Izaak Walton League of America v. AEC*, 380 F.Supp. 630 (N.D. Ind. 1974). In a letter dated February 17, 1984, to Chairman Miller, I expressed a willingness to provide the subcommittee with a copy of the legal opinion addressing these issues. In that letter I requested the subcommittee to limit its disclosure of the legal opinion in order to attempt to balance the needs of the subcommittee with competing executive branch considerations, such as the need to minimize the potential impairment of communications between agency attorneys and their clients. To date, I have received no reply. I will continue to attempt to accommodate the subcommittee's need for relevant material.

My evaluation of the status of the journal, which confirmed the view of Solicitor's Office staff that it was personal in nature and not an agency record, was not directed toward, nor did it include, any formal review of notations of meetings with individuals outside the agency for the purpose of determining the appropriateness or propriety of those meetings. However, I saw no notes, observations or other material that would have, on their face, raised such issues. If, in its review of the document now before it, the subcommittee believes that an entry in the journal raises questions about matters within OSHA's authority, I can assure you that the agency will respond quickly to the subcommittee's concerns.

Finally, you have requested a copy of a "legislative analysis." I am unable to identify any such analysis with respect to the matters you have raised and would appreciate a clarification of that request.

I hope that I have responded fully to your inquiry and will continue to cooperate in providing information pertaining generally to matters before the Department in which the Office of the Solicitor has had some involvement, such as this one, as well as matters that may be directly germane to my nomination.

Sincerely,

Francis X. Lilly

Francis X. Lilly
Deputy Solicitor of Labor

[illegible]
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United States Senate
COMMITTEE ON LABOR AND
HUMAN RESOURCES
WASHINGTON, D.C. 20510

March 9, 1984

Mr. Francis X. Lilly
Deputy Solicitor
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Dear Mr. Lilly:

Thank you for your response to my letter concerning documents which are the subject of an investigation by the House Subcommittee on Labor Standards. With respect to your response, I would appreciate it if you would provide me a copy of your legal opinion to the Assistant Secretary of the Occupational Safety and Health Administration that under the applicable legal precedent the documents did not constitute "agency records" within the official control of the Department of Labor.

In light of your scheduled appearance before the Senate Committee on Labor and Human Resources on Wednesday, March 14th, I would appreciate having a copy of this document no later than close of business Monday, March 12th.

Sincerely,

Howard M. Metzenbaum
Member
United States Senate

U.S. Department of Labor

Office of the Solicitor
Washington, D.C. 20210

MAR 12 1984

Honorable Howard M. Metzenbaum
United States Senate
Washington, D.C. 20510

Dear Senator Metzenbaum:

This is in response to your letter of March 9, 1984, in which you request a copy of a legal opinion concerning the status of certain documents previously sought and obtained by the House Subcommittee on Labor Standards.

In a letter to Chairman Miller dated February 17, 1984, I expressed the Department's willingness to provide the Subcommittee with a copy of the requested opinion if the Subcommittee would agree not to "publicly disclose the document or quote its contents during the course of [its] proceedings...." As mentioned in my letter to you dated March 7, 1984, concerning this matter, I have yet to receive, either formally or informally, any response from the Subcommittee.

I believe that such an arrangement would meet the Congressional objective of full disclosure of the legal basis for the agency determination in this matter. It would also accommodate the legitimate concern of the executive branch that advice of counsel rendered in the course of agency deliberations be protected from public disclosure in the absence of compelling circumstances. It is critical to executive branch decision-making that communications between agency attorneys and their clients during the deliberative process be as candid as possible. It is generally accepted that, in order to achieve this goal, protections of such communications from disclosure must generally be afforded. It was in the spirit of the desire to balance the legitimate concerns of our respective branches of government that I offered to provide Chairman Miller with the legal opinion in this matter under the above-described conditions.

Because I believe that the proposed arrangement is a fair and proper one, I am providing you with a copy of the legal opinion and asking that you accord it the same protections proposed to Chairman Miller.

Sincerely,

Francis X. Lilly

Francis X. Lilly
Deputy Solicitor of Labor

Enclosure

U.S. Department of Labor

Office of the Solicitor
Washington, D.C. 20210

FEB 2 1984

MEMORANDUM FOR THORNE G. AUCHTER
Assistant Secretary, OSHA

FROM : FRANCIS X. LILLY
Deputy Solicitor of Labor

SUBJECT: House Education and Labor Committee Request for Journals of Dr. Leonard Vance

I have reviewed the correspondence between you and the House Committee on Education and Labor concerning the Committee's request for journals that Dr. Vance has kept during his tenure as Chief of Health Standards for OSHA. I have also discussed OSHA recordkeeping practices and requirements with you, discussed the contents of the journals and the manner in which they were kept with Dr. Vance, and have reviewed the contents of the fourth volume of the journals. (According to Dr. Vance, volumes one and two were destroyed after having been inadvertently rendered unusuable and illegible, and volume three cannot be located. Volume four is the last complete volume recorded, covering the period from July-November, 1983).

As a result of this review, I have concluded that the journals do not constitute agency records over which you or any other agency official have control, but are in the nature of a personal diary of Dr. Vance's work-related and non-work-related activities, containing information, impressions and reminders for his personal reference. Only Dr. Vance has exercised any control over the journals and, in fact, no one else has had access to them. They were never entered into or made a part of any agency system of records but rather were treated consistently as Dr. Vance's personal property. The journals were kept, and the entries therein were made, subject only to Dr. Vance's discretion. See, British Airports Authority v. CAB, 531 F. Supp. 408 (D.D.C. 1982); Porter County Chapter of the Izaak Walton League of America v. AEC, 380 F. Supp 630 (N.D. Ind. 1974).

My conclusion that Dr. Vance's journals are not agency records and that they are not subject to your control means, of course, that you are not in a position to produce the journals pursuant to the Committee's request. I would advise you to inform the Committee of this conclusion immediately and to advise Dr. Vance that if the Committee decides to pursue its request, he may be contacted by Committee staff.

I am, of course, available if you need further assistance.

U.S. Department of Labor

Office of the Solicitor
Washington, D.C. 20210

MAR 13 1984

Honorable Howard M. Metzenbaum
United States Senate
Washington, D.C. 20510

Dear Senator Metzenbaum:

By letter of February 29, 1984, I submitted to you copies of documents and correspondence between the Department of Labor and the I.R.S., the Department of the Treasury and PBGC concerning pension plan terminations.

In a continuing review of all of the files, I have discovered two additional documents that are responsive to question No. 8 of the questions you propounded to me on February 9. Accordingly, enclosed please find a copy of a letter of November 18, 1983, from Edwin Jones, then-Executive Director of PBGC, to John Chapoton, Assistant Secretary for Tax Policy at the Department of the Treasury. As indicated on that letter, PBGC sent copies of the letter to me and to Alan Lebowitz of the Department of Labor's Pension and Welfare Benefit Programs. In addition, while I submitted to you Secretary Donovan's memorandum of December 30, 1983, to the PBGC Board of Directors on "Spin-off" Terminations, I did not provide you with my memorandum to Edwin Jones of January 3, 1984, transmitting a copy of that document to him. Therefore, I am hereby forwarding that transmittal memorandum to you.

Sincerely,

Francis X. Lilly
Deputy Solicitor of Labor

Enclosures

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

November 18, 1983

Honorable John E. Chapoton
Assistant Secretary for Tax Policy
Department of the Treasury
15th & Pennsylvania Avenue, NW
Room #3120
Washington, DC 20220

Dear Mr. Chapoton:

Since my letters of July 25 and October 26, 1983, there has been a significant increase in activity relative to "spin-off" termination cases in the Corporation, the media and the Congress.

We are approaching a critical stage in the handling of our pending cases of this kind. For example, one "retired lives" plan termination would result in a reversion of over $100 million to the Company out of about $300 million in total plan assets. The initial statutory PBGC processing period for this plan was to expire on November 19, 1983. We met with representatives of this Company last week and obtained their agreement to extend the November 19 deadline until December 1, 1983, in light of your Tax Policy Committee's reconsideration of this matter from the → Treasury viewpoint. As a practical matter, we must decide what the PBGC's position will be by November 28 in order to finalize negotiations with the Company on settlement basis, or prepare for possible legal action should we refuse to process the termination.

In this case, the Company has offered to do the following should we decide to recognize the spin-off and resulting termination:

A. Fully vest all participants to the extent of all accrued benefits for members of the terminated (retired lives) and surviving (active employee lives) portions of the plan.

B. Purchase annuity contracts for all benefits noted in A above for both the terminated and surviving portions of the plan. The same would be required in a regular plan termination.

C. Divide the resulting excess assets between the terminated and surviving portions of the plan, in a way which would result in leaving a significant excess in the surviving portion. This would provide a sizeable cushion to the PBGC and the plan participants and beneficiaries relative to the surviving plan as of the moment of termination.

D. Commit to maintaining a level of plan assets in the surviving active lives plan which is in excess the actuarially calculated plan liabilities for a period of five years after the spin-off termination with a minimum excess amount to be negotiated.

E. Agree not to seek to terminate or partially terminate the surviving plan for a period of five years.

F. Agree not to seek a minimum contribution waiver from the IRS for the surviving plan for a period of five years.

The above commitments would tend to protect the PBGC from a risk standpoint. The economic effects for the employers, the employees and the PBGC would be substantially similar to the effects incident to a plan terminated in the regular way followed by the institution of a new defined benefit plan providing benefits for service accruing after the termination date. As to that type of termination, IRS, Treasury and DOL representatives have previously advised the PBGC that it presents no problems for them. However, the commitments do not directly address our basic legal concern as to whether spin-offs of this kind should be recognized as qualified terminations under Title IV, in light of the IRS conflicting regulation on spin-offs. I note, also, that in many cases the possibility of negotiating protective commitments may not exist.

We do not want to proceed on a basis which constitutes a material difference on a policy matter between federal agencies, but time is running out. We urgently need to know the Treasury Department's position in this matter to make a coordinated and prudent decision, and request that you advise us of same by November 28. I am also in contact with DOL.

Sincerely yours,

Edwin M. Jones
Executive Director

cc: Francis X. Lilly
Alan D. Lebowitz

U.S. Department of Labor

Office of the Solicitor
Washington, D.C. 20210

JAN 3 1984

MEMORANDUM FOR EDWIN M. JONES
Executive Director, PBGC

FROM : FRANCIS X. LILLY
Deputy Solicitor of Labor

SUBJECT: "Spin-off" Terminations

Attached is a copy of Secretary Donovan's memorandum to the other members of the PBGC Board of Directors with your memorandum to Secretary Donovan attached. We sent the attached to Secretaries Regan and Baldrige on Friday, December 30, 1983.

After you have reviewed the Secretary's memo, please contact me so that we can discuss this matter further.

Attachment

U.S. Department of Labor

Office of the Solicitor
Washington, D.C. 20210

DEC 21 1983

MEMORANDUM FOR THE SECRETARY

FROM : FRANCIS X. LILLY
Deputy Solicitor

SUBJECT: Pension Plan Terminations

I am attaching a proposed memorandum from you to the PBGC Board of Directors requesting that the Board meet on an expedited basis to consider the issues raised in Ed Jones' December 9, 1983 memorandum to you. Ed's memorandum deals with two issues. The first concerns the positions adopted by the Treasury Department and IRS which would have the effect of making plan termination unlikely (because IRS would rule that the terminating plan was not a "tax-qualified" plan) in two situations: 1) when an employer terminates a defined benefit plan, seeks to recover its "surplus assets" and immediately reestablishes a similar defined benefit plan and 2) when an employer "spins off" one plan into two and immediately terminates one plan and seeks to recover its "surplus". We were informed by Treasury officials that this position had been adopted as a matter of tax policy and was not absolutely final but was fairly firm. We do not necessarily disagree with the position but were concerned that it had been adopted with little or no consideration of its likely great impact on pension policy; it also appeared that the position might result in employers simply devising new ways to terminate plans and recover surplus assets.

The second issue raised by Ed relates to a particular "spin-off and reversion" case involving the PBGC and AMAX International. Our latest information was that PBGC and AMAX had reached a settlement conditional on approval by IRS. Ed tells us that, even if AMAX settles, the same issue is being raised as to a number of other companies in the very near future.

Therefore, I recommend, as we have discussed, that you convene the PBGC Board to reach a final resolution of the issue. Rather than wait until after the holidays to convene the Board, I suggest that your memorandum be sent now so that the Board can meet, at the latest, immediately after January 3. I also recommend that Bob Monks be immediately provided the relevant materials on these issues so that he can familiarize himself with the problems during the holidays, and he and I can work as a team to develop DOL positions.

U.S. DEPARTMENT OF LABOR
SECRETARY OF LABOR
WASHINGTON, D.C.

DEC 30 1983

MEMORANDUM FOR: MEMBERS OF THE BOARD OF DIRECTORS
Pension Benefit Guaranty Corporation

FROM: RAYMOND J. DONOVAN
Secretary of Labor Signed Raymond J. Donovan

SUBJECT: "Spin-off" Terminations

As Chairman of the Board of Directors of the Pension Benefit Guaranty Corporation (PBGC), I would like to refer for your consideration a matter brought to my attention by Ed Jones, Executive Director, PBGC. The situation involves an employer's attempt to terminate that part of its defined benefit pension plan covering only retired or otherwise non-active participants. Such terminations have received Congressional and media attention in the last several months, and have been the subject of on-going consideration by the PBGC, the Internal Revenue Service (IRS) and the Department of Labor (DOL).

In the present situation, AMAX International has sought PBGC approval of a plan to "spin-off" all active plan participants into a new defined benefit plan. AMAX then intends to terminate the original plan, which would contain only retired and other non-active participants. The PBGC has previously addressed such a "spin-off" termination in the case of *In re: McLouth Steel*. In *McLouth*, the old plan terminated by the employer had substantial unfunded liabilities which would result in approximately $13 million in losses to the PBGC. In a brief filed in bankruptcy court, the PBGC stated that, as a legal matter, a "spin-off" situation is only a partial termination of the entire plan and is therefore not an insurable event triggering PBGC jurisdiction. AMAX in the present case has sought to give the PBGC assurances that PBGC risk exposure will not increase if the PBGC accepts jurisdiction of this new spin-off termination. AMAX has offered to make a number of commitments outlined in detail in the attached memorandum from Ed Jones to me. The primary thrust of these commitments would be to assure the sufficiency of the original plan and the long-term financial health of the new plan.

I understand that PBGC and AMAX have conditionally agreed to accept these commitments as a settlement of this matter. The presence of these safeguards would not alter the legal status of the proposed spin-off as a non-insurable partial termination in light of the PBGC's position in the *McLouth* case and a corresponding position tentatively adopted by the IRS and the Treasury Department which is also described in Ed Jones' memorandum.

While the particular matter may have been satisfactorily resolved between PBGC and AMAX I understand that the problem is a recurring one of immediate importance in other cases. I think it is important that an overall governmental position be considered and concurred in by all the affected agencies. Therefore, I request that the Board meet as soon as possible to consider the issues raised by this decision and by similar "spin-off" terminations.

Attachments

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

DEC - 9 1983

MEMORANDUM FOR THE HONORABLE RAYMOND J. DONOVAN
CHAIRMAN, BOARD OF DIRECTORS

SUBJECT: ERISA Policy Board Meeting and
AMAX International Situation

On December 8 the ERISA Policy Board met and discussed the following two matters:

1. The IRS letter of December 7, 1983 from Assistant Commissioner Winborne to Mr. Jones, (copy attached).

2. The factual situation with respect to the request of AMAX International pending with the PBGC, for issuance of a Notice of Sufficiency to AMAX with respect to the termination of its salaried retirement plan in a "spin-off/termination" scenario concurrently with the establishment of a substantially similar defined benefit plan for active employees.

Background on 1.

With respect to 1., the IRS-Treasury Department has now adopted the position that the termination of an overfunded defined benefit plan accompanied by the reestablishment of the substantially similar defined benefit plan, does not amount to a plan termination. Therefore any recovery of assets would be a violation of the Code because the assets would be removed from an "ongoing plan" and would disqualify the plan. This approach is called by the IRS the "substance over form" approach.

Also with respect to 1., the IRS-Treasury has concluded that when an employer splits its underfunded plan into two plans, one covering active employees and the other covering retirees, and the employer then allocates minimum permissible assets to the actives plan and terminates the plan for retired employees and recovers the excess assets, the excess assets are not properly attributable to an "actuarial error" (which would be recoverable) but rather are attributable to the spin-off and are therefore not properly recoverable by the employer. The result would be disqualification of the plan for tax purposes. The underlying theory is the same as in the preceding situation, namely that a termination of a plan has not occurred. This approach is called by the IRS the "actuarial error" approach.

However, the Treasury cautions that it wishes to look at each situation on a facts and circumstances basis with a view to determining whether the substance of the transaction, as distinct from the form of the transaction, amounts to the removal of

Discussion of 2.

With respect to 2., the AMAX International factual situation, the IRS-Treasury representatives were not prepared to make a specific commitment without reviewing all the facts and circumstances. However, on the basis of the known facts, the AMAX-proposed spin-off/termination technique would run afoul of both the IRS substance-over-form doctrine and the actuarial-error theory.

The AMAX-type situation and other defined benefit plan termination situations were discussed earlier this year on various occasions among representatives of Treasury, IRS, DOL and the PBGC. Following those occasions, the reversion of approximately $500 million of plan assets to employers since January 1, 1980 in plan termination cases has received wide publicity, as you know. Another approximately $1 billion in excess assets could revert to plan sponsors in cases presently before the PBGC. In the AMAX situation, I am advised that AMAX officials have met and discussed the matter with Treasury Department officials.

At the PBGC level, AMAX has offered to make considerable concessions from the traditional pattern that is typically followed in a termination case involving the reversion on excess assets to an employer. Under the AMAX proposal approximately $62 million of assets which might otherwise revert to AMAX would be maintained under the ongoing plan of AMAX covering active lives. As a result, the reversion would thus be reduced from about $162 million to $100 million. AMAX would also commit to maintain a $10 million funding margin for five years. AMAX is prepared to vest all employees with respect to all accrued benefits (whether or not they would be vested under terms of the plan) and is prepared to buy annuities from Metropolitan Life Insurance Company that will fully protect the participants with respect to their accrued benefits as of the date of termination. AMAX has also announced benefit improvements in the neighborhood of 10%. AMAX claims that its proposal produces a better result from both the employee side and the PBGC side than has typically resulted in cases where there is complete termination of the defined benefit plan followed by the concurrent establishment of a similar defined benefit plan. The practical result is better, they argue, because some $62 million will be held in the ongoing plan as future protection to the PBGC should company operations subsequently turn sour, and because of AMAX's $10 million commitment. Employees will be somewhat better off because they will be given some additional benefits.

Such a practical result deserved consideration, in my view, since the long-standing position of Treasury, IRS and DOL has been to recognize a complete termination of a defined benefit plan followed by the concurrent establishment of a similar defined benefit plan. The PBGC questioned that approach in December 1982 and January 1983, but was then advised that neither DOL nor the IRS had any questions about allowing such reversions.

Accordingly, PBGC lifted a temporary hold on processing that type of case and resumed to processing them in the usual way that has been followed for years.

When the AMAX spin-off/termination technique blossomed during the 1st half of 1983 in the Stroh, AMAX and other cases, I became concerned that recognition by the PBGC of the existence of the "spin-off/termination technique" would expose the PBGC to substantial liabilities in the case of underfunded plans because under that technique an underfunded plan could split its plan into a retired lives plan and an actives plan, and drop the underfunded liabilities under the retired lives portion of the plan onto the PBGC. If this became widespread, the resultant losses to the PBGC could be huge. This technique had been initiated earlier in the McLouth Steel Company case and the PBGC took the view that use of such technique was an abuse of the insurance system and that no termination of the plan had occurred. That matter went into litigation. We are now in the process of working out a settlement which I believe will reasonably protect the PBGC.

Latest Development

By July 1983 the pressure for allowing reversion of excess assets of employers in spin-off/termination cases became substantial and an ERISA Policy Board meeting was convened by me. At that meeting the Treasury/IRS concluded that they should review the situation. Their review has taken many months, as you may recall from my discussions with you in September about this matter. (My memorandum to Mr. Aubry dated September 14, 1983, an earlier memorandum of mine to Mr. Lilly dated July 29, 1983 and other memoranda relating to the intended PBGC Board consideration of this matter, are pertinent and are attached.)

The PBGC's viewpoint, has been that there is very little, if any, legal basis for concluding (but for the IRS prior position in this matter) that a plan termination recognizable under Title IV has occurred under either the spin-off/termination arrangement, or the straight plan termination/plan reestablishment technique. However, from a practical point of view it can be contended that it is better to allow leeway to employers in this area to recover excess assets (which are arising in so many cases under existing circumstances because of the high interest rates which insurance companies are assuming in pricing buy-out contracts) and to allow them to reestablish another defined benefit plan, because the PBGC may lose less premium revenue than if large numbers of defined benefit plans were to be terminated and changed into defined contribution plans (which appears to be permissible under ERISA Section (4041 (f)).

Furthermore, from a practical point of view the PBGC has recognized that the practice of allowing companies to terminate their defined benefit plans and reestablish substantially similar plans concurrently with the termination has been allowed for years by the IRS and by the PBGC, and no question has ever been raised about that practice by the IRS, PBGC or DOL. A change in that procedure may have a substantial impact on employers and on the exercise of their options with respect to the maintenance of defined benefit plans.

As I see it the present position of allowing employers to "terminate" a plan in form (by appropriate Board resolutions and other paper work) and immediately establish the same or similar plan, and to recognize these two steps as amounting to a plan termination permitting a reversion of excess assets to the employer, is highly debatable. I concur with the new Treasury conclusion that the substance of the transaction amounts to taking money out of an ongoing plan before it is terminated, and that such procedure shoul not be sanctioned under existing law. My view is the same with respect to the spin-off/ reestablishment technique.

Decision Needed

0779

With particular regard to AMAX, the PBGC is obligated by law to issue, within ninety days of its receipt of a Notice of Intent to Terminate a plan, a Notice of Sufficiency that AMAX plan assets are sufficient under Title IV to pay covered benefits. If the PBGC does not send a letter within the ninety days notifying the employer that it is unable to find a sufficiency of plan assets, or obtain a written extension of that period by agreement, AMAX may be able to secure a court order requiring us to issue a Notice of Sufficiency since its assets clearly are sufficient to cover Title IV benefits.

AMAX has given the PBGC two extensions of the ninety-day period. The most recent one will expire on December 15, 1983. AMAX has indicated that it will not give us another extension. If that position is maintained, the PBGC has two alternatives:

1. Advise AMAX that it does not recognize the spin-off termination arrangement as constituting a valid termination recognizable under Title IV and return the Notice of Intent to Terminate to AMAX. AMAX might then bring some type of court action, such as mandamus action, to force us to issue a Sufficiency letter.

2. Complete negotiations along the lines that have been started, even though the substance of the negotiated settlement would involve a recognition of plan termination, contrary to the position of the IRS and contrary to the concept of a valid

3. Request AMAX to give us another extension of the period within which the PBGC would be allowed to either issue a Notice of Sufficiency or reject the proposed transaction as a non-termination, in light of the new IRS position and pending policy consideration of this matter by the PBGC Board and the Administration. The AMAX people have already stated they would not give the PBGC another extension, particularly in light of the fact that AMAX wants to obtain the excess by the end of the

year for tax reasons and also is concerned about the possible introduction and enactment of legislation in early 1984 that would prevent asset reversions from occurring on termination of a defined benefit plan.

Pending further advice from you on a policy basis, it would appear that logical steps for PBGC to follow would be:

First, to seek an extension of time within which the PBGC may act, recognizing that the extension period if agreed to at all will be short;

Second, failing that, to serve a rejection notice on AMAX recognizing that a lawsuit might then be brought against the PBGC;

Third, to proceed with the settlement along the lines that have been proposed by AMAX to date strictly for PBGC Title IV purposes, leaving unclear what would happen at the IRS level in recognition of the fact that the IRS has advised that each case will be assessed by it on a facts and circumstance basis, and it is conceivable that the IRS would eventually conclude that the proposed settlement arrangement is justifiable and is not a case that should be treated as a "non-termination."

So far as I know the Administration, as distinct from any one Department or Agency, has never focussed on this matter. The presentation of the matter to the Board was awaiting advice from the Treasury-IRS (as indicated by the attached memoranda and proposed agenda items) as to how it was going to conclude on this matter in light of all existing facts and circumstances, including the Congressional inquiry into this matter. I understand you are proceeding with respect to Board and Administration review of this matter.

Your advice on how the PBGC should proceed with AMAX next week would be appreciated.

Edwin M. Jones
Executive Director

Attachments

cc: Mr. Lilly

December 20, 1983

PENSION PLAN TERMINATIONS AND ASSET REVERSIONS TO EMPLOYERS

I. Overview.

Treasury, IRS, and the PBGC (the Pension Benefit Guaranty Corporation) are proposing a radical change in the law that would penalize or preclude the reversion of surplus assets to an employer upon termination of a defined benefit pension plan. Any such action should be resisted -- or undertaken with utmost caution -- because it would --

- Deter the formation and generous funding of defined benefit plans
- Cause employers to switch to defined contribution plans
- Be fundamentally unfair to employers, to whom the surplus belongs, and
- Create unadministrable confusion in the pension laws.

Interested companies are prepared to work with the Administration to find a resolution that meets agency concerns while not impeding legitimate transactions. The Administration should work with industry to develop a reasonable middle ground as soon as possible.

II. Defined Benefit Plans and Current Law.

A. Because defined benefit plans typically pay employees a pension based on final pay times years of service, they serve the essential federal policy objective of providing replacement income to supplement Social Security.

B. Defined contribution plans, which pay only what is contributed plus what that grows to be, do not similarly provide a guaranteed level of replacement income at retirement.

C. Under our pension laws each employer makes a voluntary decision whether to have a pension plan and whether and when to terminate it.

1. If a pension plan has insufficient assets to pay accrued benefits when it is terminated, the employer must pay the difference to PBGC, up to the lesser of 30 percent of net worth or the value of vested guaranteed benefits.

2. If a pension plan has excess assets when it terminates --

   a. The employer must vest all accrued benefits.

   b. The employer must distribute annuities or lump sums to all participants to pay the full value of their vested, accrued benefits.

   c. Any surplus left after the discharge of all liabilities may revert to the employer.

III. Agency Positions.

A. The agencies concede that a reversion of surplus assets is permissible where an employer terminates a defined benefit plan and fails to replace it with another such plan ("DB-O"), or replaces it with a defined contribution plan ("DB-DC").

B. Where an employer terminates one defined benefit plan and replaces it with another ("DB-DB"), or where a defined benefit plan is split into two plans, one for active and the other for retired employees, with the latter plan terminated ("spinoff/termination"), the agencies propose to apply a substance-over-form or step transaction analysis.

1. Under this doctrine the termination and reversion would not be recognized where the new or continuing plan is substantially similar to the original plan and covers substantially the same employees --

- o Even though the plan is fully funded
- o Even though PBGC incurs no liabilities
- o Even though employees are fully vested at the date of the transaction.
- o Even if benefits are increased for employees.

IV. The Doctrine and Its Consequences.

A. The doctrine of substance over form is essentially a facts and circumstances test, impossible to administer with consistency or uniformity of result. If it is used, neither the government nor employers will know which transactions fall within its scope.

1. When are plans substantially similar?

2. When are groups of employees substantially similar?

3. When has too much time passed to "collapse" the steps of a transaction?

4. What substantial independent events negate the proscribed intention?

- Bankruptcy?
- Change in retirement philosophy?
- Separate plans for union and nonunion workers?
- Change in intention?
- Passage of time -- e.g., two years?

5. Would the substance over form doctrine simply reward careful planning, complexity, and disingenuity?

B. If the doctrine is adopted, the only clear and unassailable choice for employers currently maintaining overfunded defined benefit plans will be to terminate those plans and switch to defined contribution plans.

C. Use of the doctrine will deter generous funding of defined benefit plans.

1. Employers will adopt aggressive funding methods and interest assumptions to avoid any accumulation of surplus in plans.

D. Application of the doctrine is fundamentally unfair.

- Employers are entitled by statute to a reversion of surplus assets upon the termination of a defined benefit plan.
- Employees are entitled only to the benefits promised them under the plan.

V. Status and Prospects.

A. Interested companies are currently seeking to negotiate a solution with the concerned agencies. A reasonable "middle ground" has been proposed that would --

1. Protect all benefits accrued to the date of the transaction by --

- Vesting all benefits accrued to the date of the transaction
- Distributing annuities or holding dedicated investments to protect employees from downturns in the stock market.

2. Protect all benefits accrued during the five years that follow the transaction by --

- Maintaining a "cushion" in the ongoing plan
- Not terminating, spinning off, or seeking a funding waiver for five years except in stated exigencies
- Protecting PBGC through "phase down" insurance.

B. Excessive penalties or extreme rules must be prevented in order to --

- Preserve defined benefit plans.
- Assure their continued sound funding.
- Provide fairness for employers.

Without these three necessary components, the voluntary private pension system will cease to play a central role in overall federal retirement income policy.

C. Expedited action is essential.

1. Presusure is building at all agencies from a growing backlog of cases.

2. Media and Hill attention is growing daily.

3. Delay will cause employers to switch to defined contributions.

Mr. Lebowitz

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December 23, 1983

Department of the Treasury
Internal Revenue Service
Washington, D. C. 20224

Attention: Ira Cohen
OP:E:EP:T:2

Re: Cities Service Company Retirement
Income Plan

Dear Ira:

This is to confirm our conversation of today regarding the May 1, 1983 transfer of liabilities from the above referenced plan (the "CSC Salaried Plan") to the Retirement Plan of Cities Service Company and Participating Subsidiary Companies (the "CSC Hourly Plan") and the relation of that transfer to the termination of the CSC Salaried Plan.

The facts and circumstances surrounding the transfer are as follows:

Beginning in March of 1983, Occidental Petroleum Corporation ("OPC"), the parent corporation of Cities Offshore Production Company (formerly known as Cities Service Company) ("Cities"), and Cities began negotiating with the Southland Corporation ("Southland"), a Texas corporation, for the sale to Southland of all of the issued and outstanding stock of CITGO Petroleum Corporation ("CITGO"), a Delaware corporation, and with other purchasers for the sale of other properties of Cities (the "Sale Properties"). At this time, the eligible salaried employees of CITGO and the Sale Properties, specifically those employed in the Refining Marketing and Transportation Operations ("RMT") and the Columbian Chemicals Operations ("Columbian Chemicals"), were covered by the CSC Salaried Plan. In order to facilitate (i) the anticipated transfer of these employees to Southland and other purchasers and (ii) the pending restructuring of the employee benefits program of OPC and Cities with respect to their remaining salaried employees, effective as of May 1, 1983, the liabilities of the CSC Salaried Plan which were attributable to the salaried employees of RMT and Columbian Chemicals were transferred to the CSC Hourly Plan.

At the time of the transfer, both the CSC Salaried Plan and the CSC Hourly Plan held surplus assets. Moreover, the amount of the surplus held by the CSC Hourly Plan exceeded the value of the liabilities being transferred to such plan.

Pursuant to negotiations with Southland, each of the salaried employees of RMT was given a choice of (i) receiving from the CSC Hourly Plan a single premium non-participating deferred annuity contract equal to his accrued benefit under the CSC Hourly Plan, (ii) having the single sum actuarial equivalent value of such accrued benefit transferred directly from the CSC Hourly Plan to Southland's profit-sharing plan* or (iii) having the single sum actuarial equivalent value of such benefit transferred directly from the CSC Hourly Plan to an individual retirement account established on his behalf.

Pursuant to negotiations with the purchaser of Columbian Chemicals, Cities agreed to retain the liabilities attributable to benefits of the salaried employees of Columbian Chemicals accrued through the date of sale as a frozen accrued benefit.

In order to facilitate your review of the termination of the CSC Salaried Plan, Cities has agreed to take all actions necessary to reverse the May 1, 1983 transfer and include the RMT salaried employees and the Columbian Chemicals salaried employees in the CSC Salaried Plan and make such employees a part of the CSC Salaried Plan termination. Specifically, Cities will transfer the liabilities of the RMT salaried employees and the Columbian Chemicals salaried employees from the CSC Hourly Plan to the CSC Salaried Plan. With respect to the RMT salaried employees, Cities will make available with respect to the CSC Salaried Plan, the options currently available with respect to the CSC Hourly Plan. With respect to the Columbian Chemicals salaried employees, Cities will cause the trustee of the CSC Salaried Plan to purchase a single premium non-participating deferred annuity contract equal to each such employee's frozen accrued benefit under the CSC Salaried Plan.

The effect of this transfer will be to reduce the amount of surplus assets held by the CSC Salaried Plan by an amount approximately equal to $38.5 million and increase the amount of surplus assets held by the CSC Hourly Plan by the same amount. However, there will be no effect on the accrued benefits attributable to or the options available to the transferred employees.

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*The transferred employees have been participating in such profit-sharing plan since the effective date of the sale.

We understand that this completes your review of the CSC Salaried Plan and, accordingly, your office will recommend that a favorable determination letter be issued forthwith with respect to the CSC Salaried Plan termination.

If you have any questions, please call me.

Sincerely,

William W. Kravitz

William N. Kravitz

cc: Harvey Lebson
Pension Benefit ✓ Guaranty Corporation
David Root ✓
Office of Fiduciary Standards
Department of Labor
RMC 4256

MEMORANDUM

TO:

FROM:

DATE: November 22, 1983

RE: ERISA Legislative History Regarding Reversion Terminations

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INTRODUCTION

This memorandum details the references to reversion terminations in the legislative history of ERISA.[1] The official legislative history of ERISA[2] reveals that a number of pension reform bills in the 93d Congress contained references to reversion terminations.[3] It further reveals that Congress carefully considered but ultimately rejected including in ERISA a provision that would have required a plan administrator to seek the approval of the Secretary of Labor before distributing residual assets to an employer. This action indicates a clear intent by Congress to allow a plan administrator to distribute a plan's residual assets to an employer free from governmental interference once the plan has met all liabilities to participants and beneficiaries.

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[1] The Employee Retirement Income Security Act of 1974, Public Law 93-406, 93d Cong., 2d Sess., September 2, 1974. Subsection 4044(d)(1) of ERISA, 29 U.S.C. § 1344(d)(1), provides that in a reversion termination residual assets "may be distributed to the employer" if the plan so provides (and, of course, plan liabilities to participants and beneficiaries have been met). However, subsection 4044(d)(2) further provides that notwithstanding subsection (d)(1), residual assets attributable to employee contributions "must be equitably distributed to the employees who made such contributions (or their beneficiaries)."

[2] The official legislative history of ERISA is a three-volume Committee Print prepared by the Senate Subcommittee on Labor of the Committee on Labor and Public Welfare. It reprints the various pension reform bills that were introduced and made their way through the 93d Congress from January 1973 until the enactment of ERISA on September 2, 1974. The set also reprints the various House, Senate, and Conference reports on those bills, and provides transcripts of the Floor debates.

Beyond the official legislative history of ERISA, the subject of reversion terminations was discussed in a February 15, 1973 Senate hearing on proposed pension legislation before the Subcommittee on Labor of the Committee on Labor and Public Welfare. The Subcommittee heard testimony concerning a reversion termination by the Elgin Watch Company ("Elgin") of Illinois. Elgin was then in the process of terminating its overfunded pension plan, and was expected to receive about twelve million dollars in residual assets. Senator Adlai Stevenson III, who presented the witness who testified about the Elgin termination, asked the Subcommittee to include in the pension bill then under consideration an explicit provision guaranteeing that employees receive some or all of the surplus upon termination of overfunded plans. The Committee on Labor and Public Welfare did accede to Senator Stevenson's request, but only partially. It amended the bill before it to provide that residual assets attributable to employee contributions must be ratably distributed to all employee contributors.[4]

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[3] Although the bill that was finally enacted as ERISA was known as H.R. 2, the pension reform legislation in the 93d Congress centered on many bills and proposals with varying numbers. As is often the case, H.R. 2 as enacted represented an amalgam of these many bills and proposals.

The February 15, 1973 hearing reveals that Congress also considered, yet rejected, the idea that some portion of the surplus attributable to employer contributions must inure to the benefit of plan participants when the plan terminates. Instead, it clearly intended that (employee contributions aside) the provisions of the plan would govern the distribution of residual assets, and that if the plan provided for a distribution to an employer contributor this would be wholly proper.

DISCUSSION

S. 4, a bill introduced by Senator Harrison Williams on January 3, 1973 referred to reversion terminations in the context of fiduciary standards. Subsection 15(b) of S. 4, as introduced, provided an exception to an earlier provision in the bill that fiduciaries shall maintain employee benefit funds for the exclusive benefit of plan participants. The exception stated, "any assets of the fund remaining upon . . . termination . . . shall, after complete satisfaction of the rights of all beneficiaries to benefits accrued, . . . be distributed ratably to the beneficiaries thereof, or, _if the trust agreement so provides, to the contributors thereto_." (Emphasis added.)

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[4] Subsection 4044(d)(2) of ERISA, 29 U.S.C. § 1344(d)(2), retains this rule.

S. 4 was reported out of the Senate Committee on Labor and Public Welfare on April 18, 1973. Section 15(b) of the bill as reported added a second exception. This exception provided that if a terminated plan had residual assets attributable to _employee_ contributions, such assets would be ratably distributed to the employee contributors _notwithstanding_ the provisions of the trust agreement.[5]

S. 1179, which was a Senate Finance Committee bill on pension reform, also made reference to reversion terminations in the context of fiduciary standards. Subsection 551(d) of the bill as reported out of Committee listed various transactions that fiduciaries were prohibited from undertaking. However, paragraph (L) of subsection 551(d) stated that it was not a prohibited transaction "for a fiduciary to make a distribution of the residual assets of the trust in accordance with the terms of the plan to the employer who maintains the plan," after all other liabilities have been satisfied. (Emphasis added.)

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[5] S. 4 was never brought to the Senate Floor.

Section 444 of that bill listed the order in which plan assets were to be allocated in the event of a termination of any employee benefit plan. Four categories were established. Assets were to be allocated first to fund the portion of employee benefits attributable to voluntary contributions of employees; second, to fund the portion of employee benefits attributable to mandatory contributions of employees; third, to fund benefits in "pay status" for at least three years, and; finally, to fund PBGC-guaranteed benefits. Section 444 did not delineate an allocation scheme for plan assets that might remain after guaranteed benefits had been paid. However, the Senate Finance Committee Report on S. 1179, Senate Report 93-383, stated that plan assets remaining after the plan pays guaranteed benefits "are to be allocated in accordance with the plan's provisions, to the extent that . . . they conform to the antidiscrimination requirements of the Internal Revenue Code."[6]

On the House side, H.R. 9824, introduced by Congressman John Dent on August 2, 1973, provided in subsection 112(g) that in the event of termination "of any employee benefit plan," assets that remained after meeting the allocation rules set forth in the bill[7] "may, upon application to the Secretary [of Labor] and after notice, hearing, and a finding that the purpose of this subsection has been complied with, be distributed as provided in the plan."[8]

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[6] S. Rep. No. 383, 93d Cong., 1st Sess. 85 (1973). S. 1179 also never made it to the Senate Floor.

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[7] The allocation rules of H.R. 9824 provided that when a plan terminated, assets would be allocated in the following order: (1) to refund to each plan participant the amount of his contributions less the benefits received before termination; (2) to pay to all participants in pay status the present value of their benefits less the amount paid to them under paragraph 1; (3) to pay to all participants in deferred pay status the present value of their benefits, less the amount paid to them under paragraph (1); (4) to pay to all participants with accrued nonforfeitable benefits the present value of such nonforfeitable benefits, less the amount paid to them under paragraph (1); and (5) to pay to all other participants with benefits not nonforfeitable the present value of such benefits, less the amount paid to them under paragraph (1).

[8] It should be noted that H.R. 9824 did not include a provision similar to section 4041 of ERISA, 29 U.S.C. § 1341, requiring that prior to termination and the distribution of plan assets the plan obtain agency approval (in the form of a notice of sufficiency issued by the PBGC). Thus, under the rules of H.R. 9824, a plan could terminate and distribute assets in accordance with the allocation categories without prior agency approval, but approval was needed prior to distributing residual assets; this would insure that no residual assets were distributed before the plan had paid all liabilities to participants. Subsection 112(g) can also be read to mean something more than merely insuring that a plan has distributed its assets in accordance with the allocation rules before residual assets can be distributed to an employer. It may also be read to empower the Secretary of Labor to limit reversion terminations even when assets have been properly allocated. This is a key point with respect to the legislative history of ERISA regarding reversion terminations, and more research to determine whether such a reading is proper is needed.

H.R. 2 was the bill that eventually became ERISA. That bill was reported out of the Committee on Education and Labor on October 2, 1973. Subsection 112(i) of the bill, as reported, was the same as subsection 112(g) of H.R. 9824, except that 112(i) also provided that if a plan had no provision for allocation of residual assets, "such assets shall be distributed pro rata" to each participant or beneficiary that receives a distribution under the allocation rules of the bill.[9]

Moreover, subsection 112(g) of H.R. 2 as reported added a rule relating to residual assets not found in H.R. 9824. The provision was similar in content to subsection 15(b) of S. 4 as reported by Committee. It provided that after distributing assets to meet all nonforfeitable benefits, and also the present value of benefits not nonforfeitable, any remaining assets "attributable to accumulated investment earnings on employee contributions shall be ratably distributed to the employee contributors according to their rate of contribution." The House Committee on Education and Labor Report that accompanied H.R. 2, House Report 93-533, commented on subsection 112(g),

> "[t]he Committee believes it is unfair to permit the complete recapture by employers of surplus funds in terminated

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[9] H.R. 2 as reported contained asset allocation rules similar to those in H.R. 9824.

> contributory plans, without regard to the fact that contributions by the workers helped to generate the surplus. The Committee wishes to emphasize that while it is not passing judgment on any particular case now pending, it has concluded that equitable principles require that this particular subject be governed by a specific rule which reflects what the Committee regards as essential protection for the interests of workers in such plans." 10/

H.R. 2 passed the House, with various amendments made on the House Floor, on February 28, 1974. Subsection 112(d)(3) of the bill replicated subsection 112(i) as reported. Subsection 112(d)(1) was the same as subsection 112(g) in the reported version of H.R. 2.[11]

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10. H. R. Rep. No. 533, 93d Cong., 1st Sess. 12 (1973).

11. H.R. 2, as passed by the House, not only contained the notice and hearing provisions of subsection 112(d)(3), it also provided, in section 411, that a plan could not terminate and begin to distribute assets without the prior approval of the Secretary of Labor. Thus, H.R. 2, as passed by the House, required that if a plan administrator wished to terminate a plan, he had to seek authority from the Secretary of Labor prior to termination. Furthermore, once approval to terminate was granted and assets sufficient to meet plan liabilities were distributed, the plan administrator once again had to obtain authority from the Secretary of Labor to distribute residual assets. It is unclear whether section 112(d)(3) was merely redundant, or whether it was intended to empower the Secretary of Labor to limit reversion terminations even in cases in which a terminated plan distributed assets in accordance with the allocation rules of the bill. See note 8, supra. Again, more research on this question is needed.

The Senate passed H.R. 2 on March 4, 1974. Section 444 of the bill as passed by the Senate replicated section 444 of S. 1179 as reported. Subsection 522(d)(J), relating to prohibited transactions, replicated section 551(d)(L) of S. 1179 as reported. Section 15(b) of the bill, relating to fiduciary standards, replicated section 15(b) of S. 4 as reported.

None of the discussion during the Floor debates on H.R. 2 concerned reversion terminations. The Conference Report on H.R. 2 was passed by both Houses without substantive amendment,[12] and therefore it reflects the law regarding reversion terminations as it stands today.

There was, however, a discussion of reversion terminations during one of the Congressional hearings on S. 4. On February 15, 1973 the Senate Subcommittee on Labor of the Committee on Labor and Public Welfare held a hearing on S. 4, which had been introduced the previous month. One of the witnesses at the hearing was Gordon Howard, a retired employee and pensioner of the Elgin Watch Company. Mr. Howard was introduced and accompanied by Senator Adlai Stevenson III.

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[12] By Concurrent Resolution, a group of "technical amendments" to H.R. 2 was approved by each house of Congress at the same time as final passage of H.R. 2.

Mr. Howard testified about a proposed arrangement by Elgin to terminate its pension plan. His testimony was supplemented by a statement from Senator Stevenson.

Elgin was a jeweled-watch manufacturer based in Elgin, Illinois. It was founded about the time of the Civil War. It was one of the first private companies to establish a pension plan. The plan, a defined benefit plan, was established on October 1, 1918. The plan was funded by both employer and employee contributions. By 1973 the company had contributed a total of twelve million dollars to the plan, and the employees had contributed fifteen million dollars. Sometime prior to 1958 the plan became overfunded, and in 1958 Elgin responded by ceasing to make any contributions to the plan.[13] From 1958 through 1972 only Elgin employees contributed to the plan.

In the late 1960's the ownership of Elgin's common stock changed hands, and new management was established. In 1971 the company suffered heavy losses, and in 1972 Elgin decided to terminate its pension plan. The company proposed to buy annuities for all vested employees and persons already in pay status, and to take possession of the residual assets. The approximate amount of recoverable assets was twelve million dollars.

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[13] Mr. Howard asserted that the plan became overfunded significantly before 1958. His testimony, however, did not clearly indicate when Elgin first realized that the plan was overfunded.

Mr. Howard complained to the Subcommittee that it was unfair that Elgin should obtain twelve million dollars because (a) it had failed to contribute to the plan for fifteen years, and (b) the current Elgin owners had never contributed to the plan. Mr. Howard was disturbed that if the proposed termination scheme were carried out, there would be no opportunity for any future pension increases, "even cost of living" increases.

He also expressed displeasure that the plan trustees did not communicate to the participants that they were considering terminating the plan until the termination proposal had been approved, and that in general they did not represent the interests of the participants vis-a-vis Elgin. To support the latter accusation, he mentioned that the lawyer who represented Elgin in the termination matter, Milton S. Gould, not only served on the board of directors of Elgin but was a trustee of the pension fund. Mr. Howard insinuated that given his dual positions, it was a conflict of interest for Mr. Gould and his law firm, Shea, Gould, Climenko & Kramer, to represent Elgin in such a capacity.[14] Senator Jacob Javits pressed Mr. Howard for any specific instances of misconduct on Mr. Gould's part, but Mr. Howard could not point to any.

Following Mr. Howard's testimony, Senator Stevenson attempted to summarize the significance of the Elgin case for the legislative effort to regulate pension plan terminations. He stated that "the Elgin case represents the most extreme example of what can happen if the law permits companies to terminate overfunded plans at any time and for any reason": the company "will reap the benefits of a fifteen year tax-free investment program . . . [while] the employees . . . will be left to live out their retirement years on small fixed pensions."

He urged the Subcommittee to amend S. 4 to guarantee that employees "receive some or all of the surplus upon termination of overfunded plans." More specifically, he suggested that "employees could receive reasonable protection either by a requirement that the entire surplus inure to their benefit or by a requirement that any surplus available upon termination of an overfunded plan be used first to guarantee all pensioners full protection against cost of living increases."

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[14] It should be noted that Edwin M. Jones, current Executive Director of the PBGC, was a partner in Shea, Gould, Climenko & Kramer in February 1973. He joined the firm, as a partner, in 1972, after leaving a Vice-Presidency at New York Life Insurance Company.

Although Senator Stevenson clearly indicated that his proposed rule should apply regardless of whether plan contributions came from employers or employees, Subcommittee Chairman Harrison Williams (also the chairman at the time of the Labor and Public Welfare Committee) indicated that the lesson of the Elgin case, as he saw it, was that a company should not receive a surplus attributable to employee contributions. It was this concern that was directly addressed by the Committee when it reported S. 4. The Committee chose not to include a provision that would guarantee employees a portion of the surplus whenever an overfunded plan terminated; rather, as aforementioned, it amended subsection 15(b) to provide that employees were entitled to residual assets attributable to employee contributions, notwithstanding the language of the trust instrument. Moreover, it appears that the Elgin case was the impetus for subsection 112(g) of H.R. 2, and that the House Committee Report statement regarding subsection 112(g) -- "The Committee wishes to emphasize that . . . it is not passing judgment on any particular case now pending" -- was an allusion to the Elgin case.

CONCLUSION

The legislative history of ERISA regarding reversion terminations indicates that Congress specifically rejected including in ERISA (1) a provision that would have instituted a lengthy administrative process in order for an employer to recover residual assets, and (2) a provision that would have limited the amount of residual assets attributable to employer contributions that could be recovered by employers upon concluding the process.

The requirement in H.R. 9824 preventing the distribution of residual assets until the Secretary of Labor, after notice and a hearing, authorized such a distribution (a requirement that was contained in H.R. 2 as passed by the House), would have created an expensive and extremely cumbersome process for the distribution of residual assets of an overfunded plan. The Conferees' rejection of this provision, and the approval of that rejection by Congress, shows Congress's clear intent that, after satisfaction of all section 4044(a) allocation categories and after an "equitable" distribution of residual assets attributable to employee contributions (section 4044(d)(2) of ERISA, 29 U.S.C. § 1344(d)(2)), if any, the distribution of remaining residual assets should be a procedure conducted free of governmental agency influence. Once the PBGC issues a sufficiency notice in a plan termination, the plan is free to distribute all its assets. If assets remain after meeting the asset allocation rules of section

4044(a) the plan may distribute such assets (unless attributable to employee contributions) according to the plan provisions without having to go to the PBGC or the Labor Department for approval.

Congress's rejection of Senator Stevenson's request that the participants of an overfunded plan always receive some share of the surplus upon its termination, and its rejection of special approval of reversions by the Secretary of Labor (as was required by H.R. 9824) reveal Congress's intent that residual assets should inure to the benefit of the persons who funded the plan. Similarly, that rejection constitutes a strong rejoinder to the argument made by persons opposed to reversion terminations that once money is contributed to a pension plan it becomes the "property" of the participants and beneficiaries of the plan and cannot revert to the employers who contributed that money.

Manville Corporation
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303 978-2497

G. Earl Parker
Senior Vice President
Law and Public Affairs

December 19, 1983

The Honorable Raymond J. Donovan
Secretary of Labor
200 Constitution Avenue, N.W.
Suite 2018
Washington, D.C. 20210

8303370

Dear Mr. Secretary:

Manville Corporation understands that the Department of Labor is presently studying the subject of reversion of residual assets when a defined benefit pension plan is terminated. I am writing to urge that no change be made in the government's long-standing position, under which any assets attributable to employer contributions may, upon termination of a plan and after satisfaction of all liabilities to employees and retirees under the plan, revert to the employer if such a reversion is authorized in the plan documents.

As is explained at greater length in the enclosed letter to Treasury Assistant Secretary Chapoton, the establishment of additional restrictions on reversions will surely discourage the maintenance of defined benefit plans and will result in sharply reduced funding of those plans.*

By way of background, Manville Corporation filed for reorganization under Chapter 11 of the Bankruptcy Act in August 1982. That action was necessitated by the staggering volume of asbestos-related disease claims filed and expected to be filed against the company. Manville's creditors understand that if its pension plans were terminated, there would be a residue in excess of $100 million, and they are seeking to marshall this asset as part of the bankruptcy proceedings.

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* We are aware that the subject of reversion terminations is under study at the Department of the Treasury, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation as well as within the Department of Labor. Accordingly, I am writing separately to Secretary Regan on this matter (copy enclosed), and am furnishing copies of both letters to IRS Commissioner Egger and PBGC Executive Director Jones.

BEST AVAILABLE COPY

The asset would be used to pay valid asbestos health claims and other creditors.

If the plans were terminated pursuant to these proceedings, Manville would want to replace them with new defined benefit plans that would be at least as favorable to its employees as were the terminated plans. Ironically, the change in position presently being considered by the Treasury would prohibit such a replacement or would limit the circumstances under which such a replacement would be permitted. It is our understanding, however, that this change in position would not raise any new barriers to the termination of a pension plan if the company either did not establish any new plan or established a retirement income plan other than a defined benefit pension plan.

Manville's reorganization plan is premised on the emergence of a new corporation which is fully competitive and which will generate a substantial cash flow to help satisfy the asbestos claimants' demands. The new corporation's ability to attract qualified employees and to compete in our industry will be seriously undercut if we are unable to provide employees with retirement income in the form of defined benefit pension plans. To learn that we may be denied the right to establish successor defined benefit plans, thereby thwarting our efforts to reorganize one of the nation's oldest and largest employers, is therefore a matter of grave concern.

There may be circumstances under which a reversion termination could be perceived as raising substantive policy considerations. Those special circumstances should be addressed on their particular facts and not through a blanket prohibition against reversion terminations followed by successor defined benefit plans or the imposition of further generally applicable restrictions on reversions. Such action will only cause corporate management to fund pension plans at minimal required levels in order to foreclose the accumulation of excess funds in trust.

However, should you decide otherwise, I believe that an exception must be provided for situations, like Manville's, of business necessity. Manville's reorganization plan seeks to rationally order present and future asbestos-related disease claims and establish a mechanism for paying them. Emergence from Chapter 11 of a new, fully competitive company is an essential element of the plan. If Manville must terminate its pension plans to meet creditors' demands and is then not permitted to establish successor defined benefit plans, a serious risk arises that either the reorganization plan will fail to gain approval or that Manville's ability to retain and attract competent employees will be seriously undercut. Either result may ultimately lead to the loss of thousands of jobs and the termination of the plans, without any successor plans. I believe Manville's facts amply demonstrate the need for a business necessity exception should the agencies decide, for whatever reason, to restrict reversion terminations.

Manville is fully committed to providing its employees with all benefits earned under its existing plans. We are also committed to marshalling all available corporate assets to meet the many demands of claimants and creditors.

Sincerely,

Earl Parker

G. Earl Parker
Senior Vice President
Law and Public Affairs,
and Director

Enclosures

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G. Earl Parker
Senior Vice President
Law and Public Affairs

December 19, 1983

The Honorable Donald T. Regan
Secretary of the Treasury
15th and Pennsylvania Avenue, N.W.
Room 3330
Washington, D.C. 20220

Dear Mr. Secretary:

Manville Corporation understands that the Department of the Treasury is presently studying whether to change its position regarding the reversion of residual assets when a pension plan is terminated. I am writing to urge that no change be made in Treasury's long-standing position, under which any assets attributable to employer contributions may, upon termination of a plan and after satisfaction of all liabilities to employees and retirees under the plan, revert to the employer if such a reversion is authorized in the plan documents.

As is explained at greater length in the enclosed letter to Assistant Secretary Chapoton, the establishment of additional restrictions on reversions will surely discourage the maintenance of defined benefit plans and will result in sharply reduced funding of those plans.*

By way of background, Manville Corporation filed for reorganization under Chapter 11 of the Bankruptcy Act in August 1982. That action was necessitated by the staggering volume of asbestos-related disease claims filed and expected to be filed against the company. Manville's creditors understand that if its pension plans were terminated, there would be a residue in excess of $100 million, and they are seeking to marshall this asset as part of the bankruptcy proceedings. The asset would be used to pay valid asbestos health claims and other creditors.

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* We are aware that the subject of reversion terminations is under study at the Department of Labor and the Pension Benefit Guaranty Corporation as well as within the Treasury and Internal Revenue Service. Accordingly, I am writing separately to Secretary Donovan on this matter (copy enclosed), and am furnishing copies of both letters to IRS Commissioner Egger and PBGC Executive Director Jones.

If the plans were terminated pursuant to these proceedings, Manville would want to replace them with new pension plans that would be at least as favorable to its employees as were the terminated plans. Ironically, the change in position presently being considered by the Treasury would prohibit such a replacement or would limit the circumstances under which such a replacement would be permitted: It is our understanding, however, that this change in position would not raise any new barriers to the termination of a pension plan and the reversion of any residue if the company either did not establish any successor plan or established a successor retirement income plan other than a defined benefit pension plan.

Manville's reorganization plan is premised on the emergence of a new corporation which is fully competitive and which will generate a substantial cash flow to help satisfy the asbestos claimants' demands. The new corporation's ability to attract qualified employees and to compete in our industry will be seriously undercut if we are unable to provide employees with retirement income in the form of defined benefit pension plans. To learn that we may be denied the right to establish successor defined benefit plans, thereby thwarting our efforts to reorganize one of the nation's oldest and largest employers, is therefore a matter of grave concern.

There may be circumstances under which a reversion termination could be perceived as raising substantive policy considerations. Those special circumstances should be addressed on their particular facts and not through a blanket prohibition against reversion terminations followed by successor defined benefit plans or the imposition of generally applicable further restrictions on reversions. Such action will only cause corporate management to fund pension plans at minimal required levels in order to foreclose the accumulation of excess funds in trust.

However, should you decide otherwise, I believe that an exception must be provided for situations, like Manville's, of business necessity. Manville's reorganization plan seeks to rationally order present and future asbestos-related disease claims and establish a mechanism for paying them. Emergence from Chapter 11 of a new, fully competitive company is an essential element of the plan. If Manville must terminate its pension plans to meet creditors' demands and is not permitted to establish successor defined benefit plans, a serious risk arises that either the reorganization plan will fail to gain approval or that Manville's ability to compete for competent employees will be seriously undercut. Either result might ultimately lead to the loss of thousands of jobs and the termination of the plans, without any successor plans. I believe Manville's facts amply demonstrate the need for a business necessity exception should Treasury decide, for whatever reason, to reverse its long-standing policy on reversion terminations.

Manville is fully committed to providing its employees with the full benefits which have been earned under existing plans. We are also committed to marshalling all available corporate assets to meet the many demands of our claimants and creditors.

Sincerely,

Earl Parker

G. Earl Parker
Senior Vice President
Law and Public Affairs,
and Director

Enclosures

[illegible]
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December 19, 1983

Honorable John E. Chapoton
Assistant Secretary for Tax Policy
U.S. Department of the Treasury
15th and Pennsylvania Avenue, N.W.
Room 3112
Washington, D.C. 20220

Dear Mr. Chapoton:

I am writing on behalf of my client, Manville Corporation ("Manville"), regarding the position of the Department of the Treasury ("Treasury") on pension plan reversion terminations.[1] This letter is occasioned by the possibility that circumstances more fully detailed herein will require Manville to terminate one or more tax qualified pension plans it sponsors, and by Manville's understanding that Treasury and the Internal Revenue Service ("IRS") are presently studying reversion terminations and are considering which of several alternative positions to adopt respecting such terminations.

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[1] As used herein, the term "reversion termination" denotes the termination of a pension plan that is sufficiently funded so that, after satisfaction of all plan liabilities, assets remain that can revert to the company which sponsors the plan.

December 20, 1983

The Honorable John E. Chapoton
Assistant Secretary for Tax Policy
Room 3120 Main Treasury
15th St. and Pennsylvania Ave., N.W.
Washington, D.C. 20220

Re: Pension Plan Terminations and Employer Reversions

Dear Mr. Chapoton:

Enclosed is a memorandum analyzing the problems surrounding the termination of overfunded pension plans and the reversion of excess assets to the employer. It presents arguments for why changes should not be made in the law, why the substance over form doctrine is inapplicable, and why it would prove to be unworkable if applied. It also, however, suggests a "middle ground" that would address key policy concerns while not impeding legitimate transactions unduly.

We hope the memorandum is helpful. We have also delivered copies to Secretary Regan, Commissioner Egger, Assistant Commissioner Winborne, other officials in the IRS and Treasury, and interested officials in other agencies of the government. After you have read the memorandum, we would like to meet with you and other concerned IRS and Treasury officials to discuss these matters in detail.

We look forward to hearing from you soon and meeting at the earliest convenient date.

Very truly yours,

Leon E. Irish
Maureen J. Gorman
CAPLIN & DRYSDALE, CHARTERED

Donald C. Lubick
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HODGSON, RUSS, ANDREWS, WOODS
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Enclosure

December 20, 1983

MEMORANDUM

TO: The Department of the Treasury
and the Internal Revenue Service

FROM: The Ad Hoc Group on Pension Plan Terminations

SUBJECT: Pension Plan Terminations And Asset Reversions to Employers

INTRODUCTION

Pension plans traditionally provide that any surplus remaining after satisfaction of all liabilities reverts to the employer, and the Internal Revenue Service ("IRS") has routinely ruled favorably on terminations involving reversions without apparent concern for whether the employer is establishing or maintaining other qualified plans. Recently, Treasury and the IRS have decided to reexamine whether all such transactions constitute "true" terminations, despite the fact that they satisfy each of the traditional and technical requirements of the Code[1] and Treasury Regulations. The undersigned have met with IRS and Treasury representatives to discuss these questions. The purpose of this memorandum is to provide a framework for considering the relevant issues.

The signatories of this memorandum are all experienced tax and pension lawyers. Although each has one or more client interests in this matter, the analyses and comments expressed herein are directed towards a single objective: achieving a solution consistent with encouraging the establishment and maintenance of defined benefit pension plans. The fundamental concern expressed in the memorandum is that any rule or policy that precludes or penalizes reversions would have a seriously adverse effect upon defined benefit plans. At best, it would tend to cause employees to opt for less costly and generous funding methods, in order to reduce the build-up of plan surpluses; at worst, it would dissuade employers from establishing or continuing to maintain defined benefit plans.

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[1] All Code citations are to the Internal Revenue Code of 1954, as amended.

Any resolution of the reversion issue should be fair to employers, protective of benefits for employees, and consistent with the overall federal policy of encouraging defined benefit plans. The position taken in this memorandum is that, where a termination transaction has substantial independent significance and provides adequate protection to participants for past and future benefit accruals, the transaction should be recognized as valid. We believe that the proposals offered in this memorandum satisfy these two criteria, while at the same time addressing the valid concerns that have been raised about possible abuses.

The undersigned also urge expedition. Any delay in resolving the reversions issue could have a detrimental impact on the retirement expectations of thousands of employees, for those companies which sense that it will be difficult to obtain a reversion while establishing or continuing a defined benefit pension plan may well decide to avoid those difficulties by establishing a defined contribution plan or, worst yet, no plan at all. Some companies have already taken such actions, and it is likely that others will follow suit if this issue is not resolved quickly.

DISCUSSION

I. The Legal and Policy Grounds for Permitting Reversions.

A. The Employer is Legally and Equitably Entitled to a Reversion Upon Plan Termination.

It is fundamental to federal pension law that upon the termination of a defined benefit plan an employer is entitled to a reversion of assets that are not attributable to employee contributions if (1) all liabilities of the plan to participants and their beneficiaries have been satisfied, (2) the plan provides for such a reversion, and (3) the reversion does not contravene any provision of law. ERISA § 4044(d);[2] Code § 401(a)(2). See also Rev. Rul. 83-52, 1983-13 I.R.B. 7; LLC Corp. v. PBGC, 703 F.2d 301 (8th Cir. 1983); Walsh v. Great Atlantic & Pacific Tea Co., 96 F.R.D. 632 (D.N.J. 1983); Washington-Baltimore Newspaper Guild Local 35 v. Washington Star Co., 555 F. Supp. 257 (D.D.C. 1983).

The rationale for this principle of pension law is clear and generally accepted by all parties with a stake in the security of pension benefits. The primary reason for this principle is to encourage employers to establish defined benefit plans and to fund them adequately. Another reason, often unstated, is fairness to the employer. A rule forbidding reversions would presumably require either continued maintenance of the plan until the surplus is exhausted or distribution of excess assets to employees upon plan termination. However, mandatory maintenance of plans is fundamentally inconsistent with the tenets of the private pension system. Further, distribution of surplus to employees would constitute a purely unpromised, unbargained-for, unearned windfall to them, whereas in actuality and fairness, any such surplus belongs to shareholders.

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[2] All ERISA citations are to the Employee Retirement Income Security Act of 1974, P.L. 93-406, as amended.

B. A Broadscale Attack on Reversions Where a Defined Benefit Plan is Continued Will Induce Employers to Replace Overfunded Defined Benefit Plans With Defined Contribution Plans or With No Plan at All.

It is clear that a reversion of surplus assets is permissible where an employer terminates a defined benefit plan and fails to replace it with another such plan ("DB-0"), or replaces it with a defined contribution plan ("DB-DC"). Furthermore, the responsible federal agencies have for years shown no apparent concern for those cases in which the employer re-establishes or continues another defined benefit plan. However, the Treasury and IRS have recently begun to question whether a reversion should be permitted where the employer terminates one defined benefit plan and replaces it with another ("DB-DB"), or where a defined benefit plan has been split in conformity with the requirements of Code section 414(l) and ERISA section 208 into two plans, one for active and the other for retired employees, with the latter plan terminated ("spinoff/termination").

Recognition of plan terminations in the context of a DB-DB or spinoff/termination is necessary in order not to deter the formation and maintenance of defined benefit plans. To the extent that defined benefit plans assure retirement income for covered workers that is equal to a specified percentage of pay at retirement, they implement the important federal policy objective of assuring adequate replacement income for retired workers. A defined contribution plan, by contrast, pays out only what has been contributed plus what those contributions grow to be, which may not bear any meaningful relationship to final pay at retirement. In other words, defined benefit plans can be used to provide systematically for predetermined levels of replacement income at retirement in ways that defined contribution plans typically do not.

If the IRS were to prohibit reversions in the context of DB-DB transactions or spinoff/terminations, many employers currently maintaining overfunded defined benefit plans would simply terminate their defined benefit plans without replacing them or would replace them with defined contribution plans, in order to avoid any question as to their right to a reversion.

The undersigned know of a number of companies that are prepared to do a DB-DC, if that is the only way they can obtain a reversion. Precluding or penalizing reversions in DB-DB or spinoff/termination transactions would add significantly to the list of incentives already leading employers to abandon defined benefit plans in favor of defined contribution plans, including the following: the uncertainty presented by the Norris case and Rev. Rul. 79-90, 1979-1 C.B. 155; complex minimum funding requirements imposed by ERISA and the regulations thereunder; the growing burden of plan termination insurance; the proposed increase in the PBGC premium and the prospect for vastly increased premiums in the future; the legislation proposing that no collectively-bargained defined benefit plans can be terminated without prior union approval; the legislation proposing a continuation of employer liability upon the sale of a business and transfer of a plan to the buyer.

C. Precluding or Penalizing Reversions Would Deter Conservative Funding of Defined Benefit Plans.

Limiting reversions in a DB-DB or spinoff/termination transaction will deter the conservative funding of defined benefit plans. The pension system is voluntary, both as to the establishment and maintenance of a plan and as to the way in which it is funded. It is permissible to use any of a number of different "funding methods" in a defined benefit plan, and many different sets of actuarial assumptions are within the range of reasonableness required by ERISA. Of course, some funding methods and actuarial assumptions produce substantially larger contributions than others.

For example, under the "unit credit" method, an employer makes annual contributions of the present value, based upon reasonable actuarial assumptions, of the benefits that accrue each year. The contribution required in a given year for a given employee is always less than the contribution required to fund the same benefit accruing in the same year for an older employee.[3] Accordingly, the cost of funding a plan in this way rises from year to year for each covered employee, and the annual increase itself increases, if the average age of participants goes up. Under this method the funding cost in some cases can become so large in later years as to strain the employer's ability to maintain the plan.

In order to avoid these large, later-year costs, and to provide more uniform, budgetable costs from year to year, many employers adopt funding methods that level out costs (*e.g.*, the "entry age normal" method). As compared with the unit credit funding method, level funding methods generally result in higher costs in early years and lower costs in later years.[4] Thus, under level funding methods early-year contributions intentionally exceed the value of benefits accrued for those years.

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[3] The pattern is similar to the annual term insurance costs for an individual maintaining a constant amount of life insurance until retirement.

[4] This is similar to the difference between purchasing life insurance on a level premium basis and purchasing it on a yearly renewable term basis; the former results in a buildup of cash values because early-year premiums exceed the annual cost of insurance in those years.

The collection of rules and laws that currently provide inducements for maintaining defined benefit plans and funding them in a conservative, generous way constitutes a delicate balance that would be seriously distorted by any new doctrines that preclude or penalize plan reversions. This can be illustrated by looking at the tradeoffs in cash and tax costs that employers face in selecting funding methods and actuarial assumptions.

1. Tax and Cash Flow Considerations.

The front loading that is inherent in level funding methods requires that the employer make contributions to the plan before they are needed to match accrued benefits. This premature cash drain on the employer is balanced by the fact that the employer gets a tax deduction based upon contributions to the plan rather than liabilities accrued under the plan. Once in the plan, money grows tax-free because of the exempt status of qualified plans. From the employer's perspective this fact, plus the deductibility of contributions, balances the fact that any reversion to the employer upon plan termination is fully includable in income in the year of receipt.[5]

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[5] Whether taxes are actually paid on the reversion in the year of receipt depends upon the overall tax position of the employer. Even if the employer has large net operating loss carryforwards or carrybacks, however, there is a tax cost to the employer, for the reversion reduces those NOL's, which would otherwise shelter a comparable amount of other income. Indeed, the generous system of NOL carryforwards and carrybacks contained in the Code evidences a Congressional intention to tax businesses on their experiences over time, not on a strict year-to-year basis.

The taxability of reversions, of course, operates as a major deterrent to plan terminations.

This delicate balance of tax and cash considerations, which currently encourages the formation and sound funding of defined benefit plans, would be upset if reversions were precluded or penalized. If the cash drain of early large contributions were no longer balanced by the certainty of receiving surplus assets upon termination, or if reversions were subject to penalties disproportionate to the tax benefit incurred by the employer at the time of contribution, employers would, in effect, be encouraged to avoid accumulating assets equal to or greater than the value of accrued benefits. Thus, employers would tend to adopt more aggressive interest assumptions, thereby decreasing the likelihood that surplus plan assets would result from actual investment performance. The result of this for ongoing plans, of course, would be that actual performance would more frequently fall short of the assumed rate of return, creating potentially serious shortfalls in plan assets compared to plan liabilities. Similarly, if reversions were precluded or penalized, employers would tend to adopt the unit credit method of funding rather than a level funding method, for the unit credit method more nearly matches annual contributions with annual increases in benefit accruals. Because the later-year costs under the unit credit method can be burdensomely high, however, more frequent use of this method would make defined benefit plans more difficult to maintain in later years. This would, in turn, cause some employers to replace defined benefit plans with defined contribution plans, or not to adopt defined benefit plans in the first instance.

2. Qualitative Considerations.

In addition to tax and cash considerations, nonquantifiable factors would deter the formation of defined benefit plans and their conservative funding if reversions were prohibited or penalized. Under current law employers are free, consistent with the permanency and other qualification considerations, to establish and terminate plans when it is best in their judgment to do so. If reversions were penalized or precluded, employers that wanted to fund retirement benefits at a cost which was a predictable, uniform percentage of covered compensation, and that did not want to risk generating windfall benefits for employees or forgo the right to terminate the plan, would choose a defined contribution rather than a defined benefit plan.

3. Conclusion.

In sum, the rules that make up federal pension law cannot be evaluated singly, each on its own, nor can individual rules be altered without the change reverberating throughout the entire complex structure. Existing and traditional doctrines, under which the establishment and termination of a pension plan is generally a voluntary business decision by the employer, under which there are incentives for the use of level funding methods and conservative actuarial assumptions, and under which surplus assets revert to the employer, undoubtedly make it likely that many plans will at some point have assets in excess of the value of accrued benefits. Inevitably, some of these plans will be terminated and, after all of their liabilities have been discharged, the remaining surplus will revert to the employer. Changes that would penalize or preclude such reversions, however, would inevitably deter conservative funding and the very establishment of defined benefit plans.

Current concern over plan terminations does not arise from any change that has occurred in the traditional rules and practices governing the operation of pension plans. Rather, it has come to the fore only recently because traditional pension rules have been working in predictable ways to produce substantial assets in excess of the value of accrued benefits in plans where employers have used level funding methods and conservative interest rates. At the present time, this build-up of assets in excess of the value of accrued benefits and the tendency towards selective termination of plans with such excess assets has been dramatically accelerated by the extraordinary bull market of 1982-83 and unprecedented high interest rates.[6] Action taken now with the intention of redressing this probably temporary phenomenon will weaken the funding of defined benefit plans in the long run. Worse, it will deter the adoption of these plans, which play an essential role in overall federal retirement income policy.

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[6] Attention has no doubt also been focused on these questions because of concern about plan dumping under Title IV of ERISA and the risk management problems of the Pension Benefit Guaranty Corporation ("PBGC") that can result when excess assets are "stripped" out of overfunded plans. This memorandum does not address Title IV questions because it is not the responsibility of Treasury or the IRS to solve Title IV problems. It seems clear, however, that PBGC has ample tools in the provisions of Title IV to address its separate concerns.

For these important reasons, any change in the traditional rules should not constitute a blanket prohibition on reversions, but rather should be limited to the narrow class of cases that involve palpable abuse. The need for clear and precise guidelines in the application of any remedy is obvious: a vague or amorphous remedy that is susceptible to conflicting or variable application would have the same effect as a blanket prohibition — employers would avoid the uncertainty caused by such a rule by ceasing to fund defined benefit plans on a conservative basis or by abandoning defined benefit plans completely.

II. Recharacterization.

A. An Inappropriate Remedy.

The doctrine of "substance over form" or "recharacterization" is being considered as a possible antidote to the potential abuses associated with plan terminations. As outlined below, application of the doctrine to pension plan terminations would represent an unwarranted extension of the doctrine beyond the situations in which it has previously been applied. In addition, the doctrine is a vague and imprecise weapon whose application is highly subjective. In consequence, its application to pension plan terminations would impose an unworkable administrative burden on District Directors, who must annually examine and rule upon the termination of thousands of qualified plans. The application in the field of any such doctrine, however well intended or articulated by the National Office of the IRS, would generate inconsistent -- and consequently inequitable -- results. Finally, the penalization of transactions to which the doctrine was applied, as well as the inevitable uncertainty as to which transactions fall within the scope of the doctrine, would severely deter the maintenance and sound funding of defined benefit plans.

B. *A Dramatic Extension*.

The Internal Revenue Service has traditionally invoked the doctrine of substance over form, as well as the not entirely distinguishable "step transaction" and "business purpose" doctrines, to recharacterize transactions in order to deny their intended effect for tax purposes where the steps in the transaction have lacked substantial independent significance and where the taxpayer's sole motive in choosing the transaction's form has been to avoid federal taxes. Thus, the intended and necessary effect of applying the doctrine has been to produce or protect tax revenues.

The doctrine has been invoked perhaps most frequently in the areas of section 351 transactions, tax-free reorganizations, and liquidation-reincorporation situations.[7] To our knowledge, it has never been applied in the area of plan terminations and reversions. In fact, application of the doctrine to the termination of an overfunded defined benefit plan would actually result in reducing revenue. Thus, application of some version of the recharacterization doctrine to preclude or penalize the termination of overfunded plans would extend the doctrine to an area to which it has never before been applied, and for a purpose for which it has never before been used. It is certain that any broadbased utilization of the doctrine here would reduce revenues and deter sound funding of pension plans, odd results indeed for a doctrine whose use would be justified, if at all, only as a means of implementing overriding tax policy concerns.

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[7] *See e.g.*, *Manhattan Building Co. v. Commissioner*, 27 T.C. 1032 (1957) *acq.* 1957-2 C.B. 5; *McDonald's Restaurant v. Commissioner*, 688 F.2d 520 (7th Cir. 1982); *Telephone Answering Service Co. v. Commissioner*, 63 T.C. 423 (1974), *aff'd per curiam*, 546 F.2d 423 (4th Cir. 1976), *cert. denied*, 431 U.S. 914 (1977).

C. Application of the Doctrine Will Generate Inconsistent Results.

The doctrine of substance over form has proven difficult to administer with any degree of consistency or uniformity of result, perhaps because, as Bittker and Eustice observe, there is no universally accepted test as to when, and for that matter how, the doctrine will be applied in any given case. Bittker and Eustice, Federal Income Taxation of Corporations and Shareholders (4th Ed.).[8] As a result, the doctrine has undermined the even administration of the tax laws and injected substantial uncertainty into the planning of corporate transactions. See generally J. Isenbergh, "Musings on Form and Substance in Taxation," 49 University of Chicago Law Review, 859 (1983).[9] The same difficulties will inevitably plague any attempt to apply the doctrine in the area of pension plan terminations.

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[8] See also Security Industrial Insurance Co. v. United States, 702 F.2d 1234, 1244 (5th Cir. 1983): "The types of step transactions are as varied as the choreographer's art: there are two steps, waltzes, foxtrots, and even Virginia reels. As a consequence, the courts' applications of the step transaction doctrine have been enigmatic."

1. The Doctrine and Its Consequences.

Assuming that a version of the doctrine similar to that applied in the tax area were used in pension plan termination cases, a plan termination that otherwise satisfied the traditional and technical rules for termination would apparently not be recognized where (1) an employer terminates a defined benefit pension plan and establishes or continues to maintain a substantially similar plan covering substantially the same employees,[10] (2) the transaction lacks substantial independent significance, and (3) allowing the reversion would result in an impermissible erosion of the security of past and future benefit accruals. The result of applying the doctrine after the fact in any particular case would be to disqualify both the old and new plans, which is, of course, a strange way to protect the security of plan benefits. Additionally, there would apparently be excise taxes generated by reason of a prohibited transaction that was not exempted under Code § 4975(d)(12).

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[9] "The sort of creative jurisprudence found in the cases on form and substance cannot, in the end, be justified by any demonstrable needs of sound tax administration." Id. at 881.

[10] It is the absence of this criterion, of course, that makes the substance over form doctrine unavailing in DB-DC or DB-O situations. The aspect of the reversions problem that militates most strongly for crafting a clearly defined remedy and applying it cautiously is that stringent application of the substance over form doctrine to preclude reversions in DB-DB or spinoff cases will drive employers into doing a DB-DC or a DB-O — thereby causing the loss of defined benefit plan coverage for their employees.

2. Difficulties in Applying the Doctrine.

Innumerable, and probably insuperable, difficulties would confront any effort to apply this doctrine. When are groups of employees substantially similar? When the groups are ninety percent the same? Fifty-one percent? Are the groups similar if the eligibility rules are changed, such as from one year and age 25 to three years without an age limit? Are the groups substantially similar if a plan covering salaried employees is replaced with one covering salaried and hourly workers?

And, when will plans be regarded as substantially similar? Will the doctrine be invoked if an employer replaces a final pay plan with another final pay plan, but not if a career average plan is replaced by a final pay plan? What if a plan not integrated with Social Security is replaced with one that is, or vice versa? Or, what if a step-rate integrated plan is substituted for an excess-only plan, or vice versa? If the old benefit formula was 1 1/2 percent per year for the first 25 years of service, is a replacement plan substantially similar if it provides 2 percent accruals for the first 20 years and 1 percent accruals for the next ten? Are two plans substantially similar if one has 10 year cliff vesting and the other graded vesting from 5 to 15 years of service? What if one plan offers subsidized early retirement and joint and survivor annuities and the other does not? Or, what if one provides automatic post-retirement cost of living adjustments and the other does not? There is, in truth, no finite limit to the ways in which one plan can differ from another. Moreover, superficially similar plan designs can produce significant differences in actual benefits, and apparently dissimilar designs can produce remarkably similar results. Will the IRS look to some factors but not others? Similarity in stated provisions or in results? Whatever lines might be drawn or distinctions made, it seems certain that the agile minds and pens of plan drafters will be able to create plans that are not "substantially similar" according to those rules, but that in fact are very much alike.

Timing is another critical element in the application of the step transaction doctrine. It is not an issue, of course, if all of the "steps" occur more or less simultaneously. If they occur five years apart, however, the transaction may not be recharacterized even if it is in all other ways identical to a transaction that would be recharacterized if everything had occurred at once. How much time has to elapse before a transaction is so "old and cold" that the step transaction doctrine does not apply? Obviously there can be no certain answer to such a question — but this very kind of uncertainty makes the doctrine difficult both for the government to apply and for taxpayers to predict.

Then there is the elusive matter of intention. A transaction will apparently not be recharacterized unless obtaining a reversion was the motive or purpose of the transaction. However, even if a lesire to get back surplus assets is present, a transaction would not be recharacterized if there was a substantial independent reason for it.[11] What, though, is to count as such a reason?

Suppose that an employer maintaining an overfunded defined benefit plan desires to terminate the plan and institute a defined contribution plan. However, because of union resistance, the employer is forced to spin-off and terminate only that portion of the plan covering nonunion employees, for whom a defined contribution plan is subsequently established. Would the termination and replacement of the nonunion plan go unrecognized in light of the continued existence of the defined benefit plan for union employees?

Alternatively, suppose the employer, as a fundamental change in retirement income philosophy, decides to replace its defined benefit program with a defined contribution plan funded with employer stock. Further, the new plan is designed and funded so that, if the company's profits increase significantly, the annuity value of the defined contribution accounts will exceed the value of the pensions that would have been payable under the pension plan. In order to provide protection against a downturn in the stock market and to ensure that employees always get at least a minimum pension, the employer adopts a "floor" defined benefit plan. Under this plan a pension is paid to each employee equal to the amount, if any, by which the annuity value of the defined contribution account for any employee at retirement falls below a stated pension amount contained in the floor plan formula. Does an employer who changes its retirement program in this fundamental way risk having a District Director determine that the prior pension plan was never "really" terminated?

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[11] Apparently, a desire to use surplus assets to stave off bankruptcy or to build a new facility is not to be allowed as a "substantial independent reason," though why this is so is not entirely clear. And, what if a publicly traded company that must reflect surplus plan assets in its financial statement justifiably fears that it will be the target of a hostile takeover bid that will be financed out of the surplus assets if the bid succeeds (because the takeover company will have no compunction about terminating a defined benefit plan and replacing it with a defined contribution plan). Would the target company be acting out of a permissible or an impermissible motive if it sought to get the surplus out to avoid a takeover, but wanted to continue to maintain a defined benefit plan for its employees?

Or, to take another example, suppose that an employer terminates a defined benefit plan in order to get the surplus, and replaces it with a defined contribution plan. Suppose that the investment performance under the defined contribution plan does not live up to expectations and that the company has difficulty hiring and retaining key employees, in part because most of its competitors maintain defined benefit plans. For these reasons, the employer freezes the defined contribution plan and readopts a defined benefit plan. Will this cause the initial termination to be retroactively disregarded? What if service credit for benefit accrual purposes is given back to the date of the initial termination? What if the defined contribution plan is retained but a floor plan is added?

What if a defined benefit plan is terminated in a bankruptcy proceeding, either by agreement between creditors and the debtor in possession or at the direction of the trustee in bankruptcy, so that the surplus can be used to restore the company to financial health?

Suppose again that the company emerges from bankruptcy and, as its first act, the new management adopts a defined benefit plan. Suppose even that it was known at the time of the termination of the old plan that the new management would install another pension plan.[12] Could the step transaction doctrine be successfully applied in a case like this?[13]

Finally, the Service would be forced to determine in some instances whether the doctrine will apply where an employer is able to obtain the cash value of surplus assets without terminating a plan. Suppose that company A acquires company B at a price below the fair market value of company B because it agrees to assume responsibility for company B's underfunded pension plan. The plans of A and B are then merged and virtually all of the surplus of the original A plan is absorbed by the underfunded liabilities of the company B plan. Suppose then that company A liquidates company B (thereby terminating all of the company B employees and vesting any unvested benefits for them in the merged plan), and sells company B's assets for a price equal to their fair market value. Company A has effectively, albeit indirectly, obtained the value of the surplus of an ongoing plan without terminating either plan, yet the transaction would seem unassailable.

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[12] Here, as in all these cases, the evidentiary problem would be severe. If, as the old maxim of the common law has it, the Devil knoweth not the mind of man, how much more inscrutable is the "intention" of a corporation.

[13] This problem could of course arise not only in the context of bankruptcy proceedings, but wherever a change of management occurs in connection with a plan termination.

The foregoing examples only begin to suggest the innumerable difficult decisions that District Directors would be required to make. Because all such judgments could not possibly be covered by general principles promulgated in Treasury regulations or directives from the National Office, the result would be haphazard and unpredictable determinations at the District Director level. Finally, and worst of all, the step transaction doctrine would be, not so much an impediment to abusive transactions, as an inducement, and even a reward, for cunning, artifice, and indirection.

In fact, if the doctrine of substance over form were adopted by Treasury and IRS and upheld by the courts, the only clear and unassailable choice for an employer would be to terminate the defined benefit plan and switch to a defined contribution plan, or no plan at all, in order to recapture the pension surplus free of any penalty. The rash of pension plan terminations followed by adoption of defined contribution plans that would almost surely ensue would be a major blow to sound federal retirement income policy. Moreover, the employees most affected would be older participants and those least able to protect themselves. Older participants would be at risk during their final years that a sharp market decline would erode their benefits for those years, yet would not be able to benefit from the "old and cold" rule that would let the employer reinstate a pension plan after a period of years had passed. Strongly organized employees might well be able to preserve their pension benefits through collective bargaining, albeit at the cost of other things they might have had, whereas nonunion or more weakly organized employees might not be able to resist an employer's determination to change to a DC.

3. Conclusion.

Any attempt to administer the recharacterization doctrine in a consistent and even-handed manner in the pension plan area would be an exercise in frustration. Application of the doctrine will inevitably produce inconsistent results and may in some instances unfairly penalize legitimate transactions. The ultimate effect will be to deter the formation or sound funding of defined benefit plans or to encourage employers to engage in increasingly complex and devious maneuvers to avoid application of the doctrine.

III. A Logical Alternative.

Should Treasury and IRS choose to apply the doctrine of substance over form, notwithstanding the serious disadvantages associated with that doctrine, every effort should be made by the National Office to clearly delineate the types of transactions which properly fail outside of the scope of the doctrine. Such action would enhance the administerability of the doctrine, would provide certainty for plan sponsors, would reduce the chances that legitimate transactions might be unfairly penalized, and would thereby alleviate the deterrent effect the application of the doctrine will exert on the formation and funding of defined benefit plans.

In the tax area, application of the doctrine in any one of its many variations is generally triggered only by the presence of an abuse, such as where the taxpayer's choice of form is without substantial economic reality, is a sham, or is dictated solely by tax avoidance motives.[14] Attempts by the Service to recharacterize a transaction in the absence of these factors, in order to extract the tax that would have been paid under the most costly of several alternatives, has been roundly criticized by courts and commentators alike.[15]

Assuming that the doctrine were administered in the area of pension plan terminations in a manner comparable to its sound application in the tax area, it would apply only where (1) the sole motive was to obtain a reversion of surplus plan assets, (2) the transaction lacked substantial independent significance, and (3) the reversion would result in an impermissible erosion of the security of past and future benefit accruals. This means that the doctrine would not apply — that is, that terminations of overfunded pension plans and the reversion of excess assets to the employer would be allowed — where (1) the transaction has substantial independent

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14. Rev. Rul. 78-330, 1978-2 C.B. 147.

15. Bittker characterizes this version of the doctrine as a "rogue offshoot" and "drastic extension," rather than a mere restatement, of the substance-over-form doctrine. This form of the doctrine has apparently been seldom invoked by the Service. Bittker, Federal Taxation of Income, Estates and Gifts; 4-42 to 4-43 (1981).

significance or (2) adequate protection is provided for past and future benefit accruals.[16]

Where an employer terminates one defined benefit plan and replaces it with another (DB/DB), the transaction has substantial independent significance. All participants in the first plan must be vested in all benefits accrued under that plan, and the employer cannot receive a reversion of excess assets until all participants have received the full value of their accrued pensions, either through the distribution of paid up annuities or the distributions of cash sums equal to the value of their pensions. In short, the usual pension plan rules assure that there is full satisfaction of — and hence perfect security for — all past accruals in a DB/DB transaction.[17]

In the case of the spin-off/termination transaction, the full vesting and annuitization or lump sum requirements insure the security of benefits accrued under the terminated plan. With respect to the ongoing plan, section 414(l) of the Code insures that sufficient assets are allocated to it to satisfy all benefits accrued to the date of the spin-off on a termination basis. Where an employer takes the further step of purchasing and agreeing to hold dedicated investments indefinitely, such as a dedicated bond portfolio, a guaranteed investment contract, or a group annuity contract, to cover the benefits accrued to the date of the spin-off, all past accruals in the ongoing plan are fully protected.[18]

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[16] Of course, the doctrine would not be invoked where the facts in a particular situation make it inapplicable — such as where a long enough time had elapsed between the steps to invoke the "old and cold" rule. (This rule is usually a bright line standard for determining whether the proscribed intention existed at the outset).

[17] Indeed, there is some strong sentiment within the Ad Hoc Group that a DB-DB transaction has sufficient independent significance to be invulnerable to any step-transaction analysis. Under this view, no additional measures or concessions are necessary in order to obtain a reversion of excess assets from the existing DB other than full compliance with the ordinary rules for terminating a plan. Simply put, the contractual obligations of the terminated plan are fully satisfied upon payment of all liabilities, and the subsequent creation of a new plan does not alter that incontrovertible fact. The sponsor has paid the full toll charge to obtain the reversion and actions, if any, taken subsequently are simply irrelevant.

With respect to future benefit accruals, substantial security for future accruals is provided in a spin-off/termination transaction if the employer makes its 414(l) calculations using PBGC assumptions or better. In addition, in both the spin-off/termination and DB/DB transactions the employer can take a number of steps which would insure the safety of future benefit accruals. For example, the employer might purchase "phase-down" insurance that would insulate the PBGC from liability to the same extent that the corporation would have been protected under the five-year "phase-in" rule of ERISA § 4022. The employer could also agree not to terminate the new or continuing defined benefit plan for a period of five years or otherwise seek a reversion of plan surplus except in the following circumstances (i) on the occurrence of a stated business exigency (e.g., bankruptcy or the sale of the subsidiary whose employees were covered by the plan), (ii) when the plan is fully funded and is not replaced (or is replaced by a DC), or (iii) when the termination is approved by the IRS. The employer might also agree not to seek a funding waiver for five years unless so ordered by a court.

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[18] Vesting all participants in the ongoing plan in all benefits accrued to the date of the spin-off would add nothing to the security of past accrued benefits that could not be obtained by the purchase of dedicated investments, and thus would simply constitute an additional burden on legitimate transactions. Requiring plan-wide vesting in order to avoid recharacterization would increase potential PBGC liabilities, could be inequitable because of its variable impact on employers, and would disrupt the systematic vesting programs of employers. On the other hand, vesting does exact a toll charge from employers and provides apparent comparability with DB/DB transactions.

In DB/DB or spinoff/termination transactions where an employer adequately insures past and future benefit accruals by taking some combination of these measures, the doctrine of recharacterization has no legitimate application. Moreover, a failure clearly to demarcate those areas where the doctrine does not apply would make the doctrine vague, overly broad, and unadministrable, with the harmful result that the establishment and sound funding of pension plans would be deterred. The task of delineating which transactions clearly fall outside the scope of the doctrine should not be left to be worked out ad hoc on the basis of a vague "facts and circumstances" test. In order to insure consistent and fair treatment of such transactions, guidelines delineating the scope of the doctrine should be developed and promulgated by the National Office.

SUMMARY AND CONCLUSION

The undersigned believe that any change adopted in this area as a remedy for possible abuses associated with plan terminations must be consistent with the essential role defined benefit plans play in overall federal pension policy. The doctrine of substance over form would prove to be an inappropriate and unfortunate remedy, for its application would generate inconsistent and inequitable results, possibly penalizing legitimate transactions, and it would inevitably deter the maintenance and conservative funding of defined benefit plans. In the event Treasury and the IRS choose to apply the doctrine, the undersigned strongly recommend that employers be provided with clear guidelines as to the types of transactions that will fall outside of the scope of the doctrine in order to insure that legitimate transactions are permitted to go forward and to mitigate the harmful effects that the doctrine will inevitably inflict on sound federal income retirement policy.

One final point: Urgent action is needed. A protracted delay would have adverse consequences for employees. If employers are persuaded that the only feasible way to get a reversion soon is a DB-DC or DB-O, they are likely to take that route.

Respectfully submitted,

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Steven J. Sacher
Garry P. Jerome
PEPPER, HAMILTON & SCHEETZ

Theodore A. Rhodes
Kim Q. Matland
STEPTOE & JOHNSON, CHARTERED

Senator **Metzenbaum**. Thank you, Mr. Lilly.

Mr. **Lilly**. Thank you, sir.

[Whereupon, at 11:15 a.m., the committee recessed, to reconvene at the call of the Chair.]

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